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In the Supreme Court of the United States

OCTOBER TERM, 1946

No. ....

IN THE MATTER OF  
VAN SWERINGEN CORPORATION,

*Debtor,*

and

THE CLEVELAND TERMINALS BUILDING COMPANY,  
*Subsidiary Debtor.*

THE CLEVELAND HOTEL PROTECTIVE COMMITTEE,  
J. C. LINCOLN, GORDON MACKLIN, ROBERT H. JAMISON,  
MELVIN B. HOTT AND ROY BRENHOLTS,  
Individually and as Members of said Committee,  
and

THE HENRY GEORGE SCHOOL OF SOCIAL SCIENCE,  
Intervening Petitioners,  
*Petitioners,*

vs.

NATIONAL CITY BANK OF CLEVELAND,  
Successor Trustee,  
and

THE CLEVELAND TERMINALS BUILDING COMPANY,  
*Respondents.*

IN PROCEEDINGS FOR THE REORGANIZATION  
OF A CORPORATION.

**PETITION FOR WRIT OF CERTIORARI**  
To the United States Circuit Court of Appeals,  
For the Sixth Circuit.

*To the Honorable Frederick M. Vinson, Chief Justice of the United States, and the Associate Justices of the Supreme Court of the United States:*

Your petitioners respectfully show:

The petitioners, The Cleveland Hotel Protective Committee, J. C. Lincoln, Gordon Macklin, Robert H. Jamison, Melvin B. Hott and Roy Brenholts, individually and as members of said Committee, and the Henry George School of Social Science, respectfully petition this Honorable Court for a writ of certiorari to the United States Circuit Court of Appeals for the Sixth Circuit to review its judgment rendered May 31, 1946, confirming the order of the District Court which confirmed the Cleveland Hotel Reorganization Plan.

I.

**STATEMENT OF THE MATTER INVOLVED.**

Petitioners are or represent owners of land trust certificates evidencing equitable ownership of the Hotel Cleveland building and site situated on the Public Square in Cleveland, Ohio. Their trustee (The National City Bank of Cleveland as successor-trustee to the Guardian Trust Company, the original trustee), is lessor of the building and site under a 99-year lease made in 1927 to a lessee (The Cleveland Terminals Building Company, a Van Sweringen company), which in 1936, while hopelessly insolvent, filed reorganization proceedings begun under Section 77-B and subsequently continued under Chapter X of the National Bankruptcy Act. Those are the parties to this appeal: the petitioning beneficiaries, the lessee-debtor, and the trustee-lessor.

The petitioners' trustee, as lessor, has a claim against the reorganizing debtor for lease indebtedness. The claim was allowed in these proceedings in the amount of \$897,562.59 as of October 13, 1936, the date the reorganization

petition was filed; and subsequently the claim was allowed in the amount of \$1,109,904.31 as of July 1, 1942, the date as of which the confirmed Plan was made effective. This lease indebtedness is partially secured by chattel mortgages, in default, held by the trustee-lessor upon substantially all of the hotel's furniture, furnishings and equipment, the value of such mortgaged chattels having been fixed at \$508,473.98 in these proceedings. The remaining part of the trustee's claim against the lessee-debtor, approximating \$600,000, is worthless, it being submerged by the debtor's unsecured indebtedness to others in excess of \$55,000,000. (R. 728.) The trust's only hope of realizing upon its claim for \$1,109,000 is therefore through enforcement of its rights as mortgagee against the \$508,000 of mortgaged personal property.

But the Plan denies to the trustee-lessor its right to full priority with respect to these mortgaged assets. Instead, it would transform the trustee-lessor's partially *secured* claim into a completely *unsecured* claim and would give this \$508,000 of property back to the debtor, freed of such lease indebtedness, by giving it to a wholly-owned subsidiary of the debtor's. (R. 129.) The Plan provides:

"Upon the claim of the Trustee for accrued and unpaid rent, and as to which the Trustee duly filed a proof of claim in the 77B proceedings, the Trustee, in respect of the amount for which said claim is finally allowed, shall receive the same relative distribution as general creditors of The Cleveland Terminals Building Company receive on the claims duly proved by them and allowed in said proceedings." (R. 150.)

The Plan provides for the transfer of the insolvent lessee's interest in the hotel property (including the lease) to a new corporation (to be called Cleveland Hotel Corporation). That new corporation is to be endowed at the start with \$646,000 of personal property; \$508,000 of which is to consist of the property covered by the trustee's chattel

mortgages but discharged of the entire \$1,100,000 of lease default; and the other \$138,000 is to consist of personal property released for that purpose by the creditors of the present lessee. *But the stock ownership of the new lessee company is not to be divided in proportion to such respective contribution of \$508,000 by the trustee and \$138,000 by the debtor. Instead, the Plan gives all of such stock to the present insolvent lessee-debtor, and thereby makes a gift to it of the trustee-lessor's \$508,000 of mortgaged chattels.*

In addition, the debtor is to reacquire complete management and control of the hotel, upon ending the court-trusteeship under which the Cleveland Hotel has been operated since 1936, through the right to have exclusive voting power of the stock of the operating company (its new subsidiary and the substituted lessee). (R. 145-146.)

In *Case v. Los Angeles Lumber Co.*, 308 U. S. 106, 122, the Court reaffirmed the decisions since *Northern Pacific Ry. Co. v. Boyd*, 228 U. S. 482, that the creditor must be accorded his full right to priority against the corporate assets where the debtor is insolvent and that participation in a reorganization "must be based on a contribution in money or in money's worth" reasonably equivalent to the participation accorded.

In the Court of Appeals the petitioners urged the applicability of those principles. If the petitioners, through their trustee, had been *only creditors*, perhaps that court might have agreed. However, since petitioners were in addition *also*, through their trustee, in the position of *lessors* to the debtor, that court rejected application of the full priority rule (as to the lessor, and the equivalent contribution rule as to the debtor). Instead of considering the issue to be whether the plan was "fair and equitable" to all those interested, within the pronouncements of the *Los Angeles* case, *supra*, that court considered the issue to be simply one of a lease adjustment and the decisive

question as being only whether the trustee had exercised "sound business judgment" in accepting the proposed modified lease. Speaking through Judge Martin, it said:

"But, in the circumstances confronted and upon analysis of the approved plan of reorganization of the lessee-debtor corporation, it would seem that *Case v. Los Angeles Lumber Co., supra, and the kindred cases cited above do not point the way to decision in the present controversy.* As stated by the district judge, this 'is not a case of stockholder retention of interest to the detriment of bondholders and creditors'; but our concern is the problem of adjustment of the rights of lessor and lessee under a defaulted lease and the modification of a lease indenture. It is true that the lessor is a creditor—in fact the largest one; but the real issue is whether its best interest would be conserved by acceptance or rejection of the proposed modified lease. The lessor-trustee was vested by the declaration of trust with full authority, in the event of the lessee's default with respect to any of the provisions of the lease, either to terminate the lease or 'to take such other action with respect to the lease or trust estate as it shall deem advisable, without reference to the beneficiaries and as if it were the sole legal and equitable owner thereof.' " (Emphasis ours.)

The Court has held, however, that approval of a plan by various classes concerned is not a substitute for the plan being "fair and equitable" *in fact*, and that "All those interested are entitled to the court's protection." The trustee's opinion should therefore not be decisive. In the opinion in the *Los Angeles* case, 308 U. S., at 114, it was stated:

"At the outset it should be stated that where a plan is not fair and equitable as a matter of law it cannot be approved by the court even though the percentage of the various classes of security holders required by Sec. 77B (f) for confirmation of the plan has consented. It is clear from a reading of Sec. 77B (f) that the Congress has required both that the required percentages of each class of security holders approve the plan and

that the plan be found to be 'fair and equitable.' The former is not a substitute for the latter. The court is not merely a ministerial register of the vote of the several classes of security holders. All those interested in the estate are entitled to the court's protection. Accordingly the fact that the vast majority of the security holders have approved the plan is not the test of whether the plan is a fair and equitable one."

The issues presented to this Court are as to the application of Section 221 of the Chandler Act (11 U. S. C. 621):

(1) Is it essential for the confirmation of the reorganization plan herein that it in fact be "fair and equitable" to all those concerned, including the land trust certificate holders<sup>1</sup>?

(2) If so, is the plan "fair and equitable" within the decisions of this Court when the plan (a) denies the creditor trustee its right of full priority and (b) gives the insolvent debtor a participation in a proportion far beyond its "contribution in money or in money's worth" to the reorganization company which is to take over the property?

(3) Have the land trust certificate holders, as equitable owners, the right to participate in the proceedings?

The trustee bank prepared the plan without any consultation with the land trust certificate holders, its beneficiaries. (R. 508.) It never seriously investigated the possibility of obtaining another lessee. (R. 546-547.) The bank framed the plan—not on the principle of giving its beneficiaries stock proportionate to their contribution to the capital of the new company, but—on the theory of giving the debtor a reward *now* for its operation of the hotel in

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<sup>1</sup> It is stated in the *Los Angeles* case, *supra*, n. 14, at p. 120: "The Chandler Act, c. 10 (52 Stat. 840) approved June 22, 1938, now supplants Sec. 77B. Various substantial changes in the provisions of Sec. 77B have been made therein. But the standard of 'fair and equitable' as used in Sec. 77B remains unaltered as one of the criteria necessary for confirmation of a plan of reorganization. Sec. 221 (2)."

*the future.* In the trustee's main brief (p. 72) in the Court of Appeals, it candidly admitted:

"The Trustee did not develop the Hotel Plan on any theory that the Building Company had any equity in the existing lease. The Plan gives recognition to the lessee in the proposed new lease only for long, successful operation of the Cleveland Hotel *in the future.* \* \* \*" (Emphasis ours.)

The Plan (R. 128-151) is dated October 1, 1940, and superseded an abandoned plan dated May 18, 1937. On August 9, 1941, the trustee submitted the plan to the land trust certificate holders and then it began an eleven-months high-pressure campaign to obtain the consent to the plan of 75% of the beneficial interests, as required by the Plan and by the trust indenture. On June 29, 1942, the trustee, ignoring notice from petitioners, who had campaigned in opposition to the Plan, that they had withdrawals of consents (R. 39), determined that it held consents in writing from three-fourths in interest (5,250 interests) of the certificate holders and accepted the plan. Petitioners challenged the effectiveness of that acceptance in the lower courts. However, since the court below held that these were issues of fact and resolved them against petitioners, petitioners do not present such issues here.

The petitioners represent, as owners or as representatives of owners, 1,262 interests out of 7,000 beneficial interests outstanding, or approximately 18%. The two respondents, the trustee and the debtor, in their joint "counter-statement of facts" in the Court of Appeals disputed this and contended (p. 16) that "The representation of the appellants is, therefore, 692 interests at the outside"—which would be approximately 10%. We shall not pause to discuss the point for either way—18% or 10%—petitioners represent a substantial amount which is entitled to protection.

The petitioners, by petition filed in the District Court, sought leave "to intervene herein and to be heard upon all questions pertaining to the Plan of Reorganization as it affects the Cleveland Hotel Building Site." (R. 67) Petitioners, as land trust certificate holders, are outside the benefit of Sec. 206 of the Chandler Act (11 U. S. C. 607) which grants "the right to be heard" to "The debtor, the indenture trustees, and any creditor or stockholder of the debtor \* \* \*." Petitioners consequently relied upon Sec. 207 of the Chandler Act, which provides:

"The judge may for cause shown permit *a party in interest* to intervene generally or with respect to any specified matter."

The District Court refused to permit any of the petitioners to intervene except on the question of the effectiveness of the trustee's acceptance of the plan (90), although none other of the beneficiaries was previously a party and although the trustee, committed from the start to acceptance of the plan, did not and fairly could not represent the viewpoint of the beneficiaries who were opposed to the plan. Consequently, the plan had no official opposition, although the District Court permitted the petitioners, after the record had been made, to argue "the fairness of the plan" "as sort of *amicus curiae*." (81) The Court of Appeals held that because petitioners had been permitted to argue all matters, "No prejudice to appellants or abuse of discretion by the district court in refusing their petitions for general intervention is apparent."

The District Court confirmed the plan on March 6, 1945, and ordered it put into execution and consummated as of July 1, 1942. (91) On appeal by the petitioners, the Circuit Court of Appeals for the Sixth Circuit, by judgment entered May 31, 1946, affirmed the order of the District Court.

## II.

**THIS COURT HAS JURISDICTION.**

Jurisdiction is invoked under Section 240 of the Judicial Code, 28 U. S. C. 347(a) and Supreme Court Rule 38, par. 5(b).

## 1.

The case presents a situation where the Circuit Court of Appeals "has decided a federal question in a way probably in conflict with applicable decisions of this Court" (Supreme Court Rule 38, par. 5(b)). In a long line of cases from *Northern Pacific Ry. Co. v. Boyd*, 228 U. S. 482, to *Case v. Los Angeles Lumber Co.*, 308 U. S. 106, and *Consolidated Rock Co. v. DuBois*, 312 U. S. 510, the Court has consistently held that creditors are entitled to their full and absolute right of priority against corporate assets; and also, as stated in the *Los Angeles* case (at p. 122), that "where the debtor is insolvent, the stockholder's"—and we submit the debtor's itself—"participation must be based on a contribution in money or in money's worth, reasonably equivalent in view of all the circumstances to the participation of the stockholders." Those principles are embodied in the concept of what is "fair and equitable"; and a finding that a plan is "fair and equitable" is essential under Section 221 of the Chandler Act to its confirmation.

But the Court of Appeals enunciated different principles. It said that "*Case v. Los Angeles Lumber Co.*, *supra*, and the kindred cases cited above do not point the way to decision in the present controversy"; that the problem is (only) one of adjusting a defaulted lease (rather than of fair and equitable treatment of an allowed claim); and that "the real issue" is (only) whether the proposed modified lease is a good one for the lessor. The principle adopted by the court below thus appears to be that the "fair and equitable" requirement of Section 221 applies to defaulted lease indebtedness where the lease is to be

*cancelled* but does not apply where the lease is to be *continued*. But if the "fair and equitable" rule, and its many carefully worked-out concepts, is to be inapplicable to one type of a continuing situation—a lease, it logically should be inapplicable also in other situations where defaulted obligations are modified and continued, such as mortgages and purchase agreements and options. It is submitted that it is important in reorganization matters to know whether the Court sanctions the inapplicability of the "fair and equitable" requirement of Section 221 to the type of situation here presented as declared by the court below.

## 2.

It seems to petitioners that the "fair and equitable" requirement, and its associated concepts, either does or does not apply to the type of situation presented. We submit that it does. The court below *said* that the *Los Angeles* case, *supra*, "do not point the way to decision in the present controversy," and nowhere in its opinion did it expressly modify or qualify that statement. However, subsequently, and as if the *Los Angeles* case did, after all, "point the way," it stated that "the trustee under the plan of reorganization of the lessee-debtor receives a fair and equitable consideration for execution of the new lease for the benefit of the beneficiaries of the trust." But while at the same time denying yet giving lip-service to the *Los Angeles* case, that statement, just quoted, does violence to the principles of the *Los Angeles* case and "the kindred cases" which rigidly enforce the full priority rule and the equivalent contribution rule. The items listed by the court as supporting that statement and as constituting "consideration" for the trustee's giving up its \$508,000 of property and the insolvent debtor's acquisition of 100% of the stock of the new operating company "have no place in the asset column of the balance sheet of the new company. \* \* \* The rigorous standards of the absolute or full priority doc-

trine of the *Boyd* case will not permit valueless junior interests to perpetuate their position in an enterprise on such ephemeral grounds." *Case v. Los Angeles Lumber Co.*, 308 U. S., at 122-123. (Emphasis ours.)

While further analysis of those items will be in our brief, the substance of the plan is that the trustee is to contribute 78% (\$508,000) of the capital assets of the new company and the insolvent debtor is to contribute 22% (\$138,000), all of which will immediately be property owned by the new operating company. The debtor, through its 100% ownership of the stock of the new company and of the exclusive right to vote it, will have exclusive control and management of the enterprise. The new company will have a reduced fixed rental under the continued lease, with the \$1,109,000 of defaulted lease indebtedness forgiven. A constantly increasing major share (from 50% upward) of the net earnings (after payment of the fixed rent) will be used to transfer ownership of the building and site from the beneficiaries to the debtor by being used to buy out, compulsorily, their land trust certificates, by lot. The remaining net earnings, a constantly diminishing minor share (from 50% downward), will be used to pay additional rent proportioned among those trust certificates which survive the draw. Thus will the net earnings be used for the purpose ultimately of making the insolvent debtor, for its contribution of 22% of the capital assets, the owner in fee simple of the entire Hotel Cleveland. The Plan is dressed up with a provision for pledging the stock for a while (without voting power in the pledgee) and for giving the trustee a chattel mortgage again for the *future* lease obligations and for a liquidated damages provision of doubtful validity. The Court of Appeals' statement that "under the plan, none of the trustee's securities passes either to the lessee-debtor or to the unsecured creditors" is inaccurate since the \$508,000 of mortgaged property passes immediately to the lessee-debtor's 100% owned new subsidiary,

freed of the defaulted lease claim for which it was mortgaged.

Thus under this ingeniously devised plan, the insolvent debtor's contribution "in money or in money's worth" to "the asset column of the balance sheet of the new company" is 22% of its capital assets. The trust contributes 78% of the capital assets, through the lease of its premises contributes the hotel site and building, and forgives its unsecured claim for \$600,000. Equitably, the participation accorded should be 78% of the stock to the trust and no more than 22% to the debtor. Instead, the debtor gets immediate ownership of 100% of the *capital* assets and the benefit of from 50% upward of the *earnings* through their use to buy for the debtor the interests of the beneficiaries in the premises.

Accordingly, when the Court of Appeals stated or determined, whichever is the case, that the items listed by it constituted "a fair and equitable consideration" for the treatment given the beneficiaries by the plan, it misapplied the reorganization law sense of what is "fair and equitable" and thereby "decided a federal question in a way probably in conflict with applicable decisions of this Court." (Supreme Court Rule 38, par. 5(b).)

### 3.

In this case also the Court of Appeals "has decided an important question of federal law which has not been, but should be, settled by this Court" (Supreme Court Rule 38, par. 5(b)), namely the right of land trust certificate holders to participate in corporate reorganization proceedings. The only determination by the Court of the rights of land trust certificate holders for any purpose that we can find is *Senior v. Braden*, 295 U. S. 422, where it was held that a land trust certificate holder has an equitable interest in the corpus of the trust, and not merely a chose

in action against the trustee. *Cf. Blair v. Commissioner*, 300 U. S. 5, 13.

The instant reorganization plan affected three interests of the land trust certificate holders: (1) *As equitable creditors*, with respect to disposition of the trust's claim for \$1,109,000 of lease indebtedness; (2) *as equitable lessors*, with respect to the proposed modifications of the lease of the entire trust corpus, and the provisions enabling the compulsory purchase of beneficial interests by the debtor; and (3) *as beneficiaries*, with respect to the proposed reorganization of the trust indenture.

The court below appears to have taken the position that the certificate holders had no right to be heard in the reorganization proceedings in their capacities (1) as equitable creditors and (2) as equitable lessors, but that the trustee had exclusive right to speak for them therein.<sup>2</sup> In this case the District Court refused to permit any

<sup>2</sup> Thus, the Court of Appeals stated (R. 835):

"It is true that the lessor is a creditor—in fact the largest one; but the real issue is whether its best interest would be conserved by acceptance or rejection of the proposed modified lease. The lessor-trustee was vested by the declaration of trust with full authority, in the event of the lessee's default with respect to any of the provisions of the lease, either to terminate the lease or 'to take such other action with respect to the lease or trust estate as it shall deem advisable, without reference to the beneficiaries and as if it were the sole legal and equitable owner thereof.' The declaration of trust provided further that, by acceptance of any certificate issued under it, the original or any successive holder should be deemed to assent to all provisions contained in the trust agreement."

The court below again indicated adherence to the position that the certificate holders had no right to participate in their capacities as equitable creditors and equitable lessors with respect to the plan, when it stated the issue in terms of the trustee's *discretion*, as follows: "Analyzing the situation confronted by the corporate trustee on July 1, 1942, did it exercise sound business judgment in considering that the terms of the new lease furnished a fair and equitable consideration for its waiver of the security behind approximately \$500,000 of the lessor's total back-rent claim?" (R. 838)

land trust certificate holder to become a party to the proceedings, although the property is their investment, but permitted only the insolvent debtor and the trustee to be parties. The Court of Appeals expressly affirmed this, stating "No prejudice to appellants or abuse of discretion by the district court in refusing their (petitioners') petitions for general intervention is apparent." (R. 830)

We submit that the question whether land trust certificate interests—a widely-held form of investment—have any right to be heard in corporate reorganizations, when the trust property is thus disposed of and affected, is an important question of federal law. If the Court of Appeals is correct, it would mean that no reorganization plan involving the interests of the land trust certificate holders would have to be submitted to them except insofar as it might involve a change in the trust indenture. The Court has rendered decisions which define the rights of creditors, mortgagees and stockholders in reorganizations, but none with respect to land trust certificate holders.

### III.

#### THE QUESTIONS PRESENTED.

1. Where the trustee for land trust certificate holders holds as such trustee a secured claim for lease indebtedness against an insolvent debtor-lessee which is in reorganization proceedings under the Chandler Act and the reorganization plan proposes to extinguish such security and to give the security assets to a new company, to be wholly owned by the debtor, which is to become the new lessee under a modified lease, is it necessary to confirmation of the Plan under Section 221 of the Chandler Act that with respect to the land trust certificate holders the Plan be "fair and equitable" as a matter of law?

2. If so, is the plan "fair and equitable" within the decisions of this Court when the plan (a) denies the credi-

tor trustee its right of full priority and (b) gives the insolvent debtor a participation in a proportion far beyond its contribution in money or in money's worth to the reorganization company which is to take over the property?

3. Are the land trust certificate holders entitled to participate in such reorganization proceedings, as parties and otherwise, only with respect to proposed changes in the trust indenture?

#### IV.

##### **REASONS RELIED UPON FOR ALLOWANCE OF WRIT.**

1. The decision of the Circuit Court of Appeals that the equitableness of the plan as to the land trust certificate holders is a matter to be determined by the trustee rather than one for the courts to determine in accordance with the established judicial standards as to what is "fair and equitable," is a decision of a federal question in a way probably in conflict with applicable decisions of this Court.

2. The considerations stated by the Circuit Court of Appeals as justifying the trustee in considering that there was "fair and equitable consideration" for accepting the plan are incompatible with the standards of what is "fair and equitable" in such cases as determined by this Court, and constitutes a decision of a federal question in a way probably in conflict with applicable decisions of this Court.

3. The decision by the Circuit Court of Appeals that it was not an abuse of discretion for the District Court to refuse the petition for intervention of the only land trust certificate holders and Committee who sought to intervene and its decision that the provisions of the trust indenture frustrated any right which the certificate holders might otherwise have under the Chandler Act to participate in the proceedings in what it called "the problem of adjustment,"

is the decision of an important question of federal law which has not been, but should be settled by this Court.

Respectfully submitted,

ROBERT H. JAMISON,

ROBERT F. LEE,

E. D. McCURDY,

*Attorneys for Petitioners.*

**BRIEF IN SUPPORT OF PETITION FOR WRIT  
OF CERTIORARI.**

**THE OPINION BELOW.**

The opinion of the United States Circuit Court of Appeals for the Sixth Circuit is reported in 155 F. 2d 1009. The opinion is in the record at page 829.

**JURISDICTION.**

The jurisdiction of this Court is invoked under Section 240 of the Judicial Code, 28 U. S. C. 347(a); and under Supreme Court Rule 38, par. 5(b), that the Circuit Court of Appeals has in this case "decided a federal question in a way probably in conflict with applicable decisions of this Court" and that it has "decided an important question of federal law which has not been, but should be, settled by this Court."

Judgment was entered in this case by the United States Circuit Court of Appeals on May 31, 1946. (R. 827.)

**STATEMENT OF THE CASE.**

The case has already been stated in the preceding petition under Section I thereof, which is hereby adopted and made a part of this brief.

**ERRORS RELIED UPON.**

The United States Circuit Court of Appeals erred:

1. In ruling that the equitableness or acceptability of the plan as to the land trust certificate holders is a matter to be determined by the trustee rather than one for determination by the courts in accordance with the established judicial standards as to what is "fair and equitable."
2. In failing to require conformation to the established judicial standards as to what is "fair and equitable" in such cases and in applying other standards.

3. In sanctioning the refusal to permit the petitioning land trust certificate holders and their Committee to intervene in the proceedings as parties and in ruling that the certificate holders had no right to participate in what it called "the problem of adjustment."

#### **ARGUMENT.**

##### **Point I.**

It is essential to confirmation of the plan that it be "fair and equitable" to the land trust certificate holders within the meaning of the Chandler Act, even though integrated into the plan are provisions for lease adjustment.

The Circuit Court of Appeals ruled that "*Case v. Los Angeles Lumber Co., supra* (308 U. S. 106), and kindred cases cited above do not point the way to decision in the present controversy" because "our concern is the problem of adjustment of the rights of lessor and lessee under a defaulted lease" and "the real issue is whether its (the trust's) best interest would be conserved by acceptance or rejection of the proposed modified lease." (R. 835) It then proceeded to test the soundness of the trustee's exercise of discretion, rather than the fairness and equitableness of the plan viewed with reference to compliance with the standards set forth in the *Los Angeles* case. (R. 838)

That was error.

The plan involved disposition of a creditor's claim, of which the land trust certificate holders are the equitable owners, in the amount of \$1,109,000 and of property worth \$508,000 held as security for that claim. The land trust certificate holders would have been entitled to protection in these proceedings against a disposition of that claim which was not "fair and equitable" as a matter of law if the only issue were the liquidation or disposition of that claim and of the property which secures nearly half of it.

They would be entitled to a judicial determination on the issue of fairness in such a case. And that which it was proposed to give to the trust in substitution for such a secured claim would have to conform as to its value to the judicial standards of what is "fair and equitable."

It is submitted that the necessity of such a judicial determination is not dispensed with by the injection into the plan of a proposal to adjust and continue a pre-existing relationship of lessor and lessee. The forum or agency for the protection of the rights of the equitable owners, and the standards applicable thereto, can not be made to depend upon the distinction as to whether the insolvent debtor desires a cancellation or continuation of a pre-existing relationship or obligation, such as in a lease.

We respectfully submit that the *Los Angeles* case and kindred cases do "point the way to decision in the present controversy" and that the instant plan must conform, as a matter of law determined by the courts—and not by the trustee—to the standards of what is "fair and equitable" with respect to the land trust certificate holders.

#### Point II.

The plan is not "fair and equitable" with respect to the land trust certificate holders in that it fails to give the creditor trustee its right of full priority and a participation in the new company equivalent to its contribution thereto.

The plan proposes that the land trust certificate holders, through their trustee, contribute 78% (\$508,000) of the capital of the new enterprise and the debtor is to contribute only 22% (\$138,000)—yet for this 22% contribution the debtor is to obtain 100% of the ownership of the new enterprise. That clearly is a denial of the creditor trustee's right of full or absolute priority and its right to a participation in the enterprise equivalent and proportionate to its contribution in value thereto. On those facts

the plan unquestionably is as a matter of law not "fair and equitable."

But it is said that the debtor makes other contributions which compensate for this. The only possible contribution of the debtor in addition to the 22% is in the promises of itself *and its new subsidiary* under and with respect to the modified lease. But those promises "have no place in the asset column of the balance sheet of the new company." *Case v. Los Angeles Lumber Co.*, 308 U. S. 106, 122-123. Those "contributions" are of the same general nature as were held insufficient for that purpose in the *Los Angeles* case, *supra*, at pp. 122-123, where it was stated:

"Such items are illustrative of a host of intangibles which, if recognized as adequate consideration for issuance of stock to valueless junior interests, would serve as easy evasions of the principle of full or absolute priority of *Northern Pacific Ry. Co. v. Boyd*, *supra*, and related cases. Such items, on facts present here, are not adequate consideration for issuance of the stock in question. On the facts of this case they cannot possibly be translated into money's worth reasonably equivalent to the participation accorded the old stockholders. They have no place in the asset column of the balance sheet of the new company. They reflect merely vague hopes or possibilities. As such, they cannot be the basis for issuance of stock to otherwise valueless interests. The rigorous standards of the absolute or full priority doctrine of the *Boyd* case will not permit valueless junior interests to perpetuate their position in an enterprise on such ephemeral grounds."

Suppose we examine the "considerations" set forth in the opinion of the Court of Appeals. They are in substance as follows (R. 838-839):

1. The trustee had no assurance that it could obtain as good a lease as that sought by the lessee-debtor.
2. If the trustee had taken over the pledged chattels and cancelled the lease, it would have had to find a new

lessee "adequately financed" and capable of good management, and it might not have fared as well.

3. If a future default by the new lessee occurs, the trustee-lessor would have better security than now.

4. A portion of the net earnings of the new enterprise is to be used to purchase the equitable ownership interests of the land trust certificate holders.

5. None of the trustee's presently owned security "passes" to the debtor or to its unsecured creditors. (It passes to the debtor's new wholly-owned subsidiary.)

6. The assets contributed by the trust (78%) will again be security for the (future) obligations of the lease, and in addition the debtor's equity of 22% also will be.

Do those "considerations" meet the test enunciated in the *Los Angeles* case (308 U. S., at 122)—

"\* \* \* that to accord 'the creditor his full right of priority against the corporate assets' where the debtor is insolvent, the stockholder's participation must be based on a contribution in money or in money's worth, reasonably equivalent in view of all the circumstances to the participation of the stockholder."?

We submit that they do not.

We proceed to examine them, one by one.

1. Clearly, lack of assurance possessed by the trustee that it could obtain as good a lease elsewhere does not constitute a contribution by the debtor to the new enterprise. That is not a "balance sheet" item. It is not a factor equivalent to the 78% contribution by the trust. If the trustee lacked such assurance, it is explainable by the testimony of the officer in charge of the bank department which administers the trust (R. 508) that the bank never seriously investigated the possibility of obtaining "a new lessee" or a lease on better terms (R. 546-547). Nor was it shown to be necessary to make a gift of the \$508,000 of property in order to get a lessee.

2. With respect to the suggestion that the trustee might not fare as well if it foreclosed, we quote the Court's answer in the *Los Angeles* case (at pp. 123, 124) to the similar contention made there:

"The fact that bondholders might fare worse as a result of a foreclosure and liquidation than they would by taking a debtor's plan under Sec. 77B can have no relevant bearing on whether a proposed plan is 'fair and equitable' under that section. \*\*\* To hold that in a Sec. 77B reorganization creditors of a hopelessly insolvent debtor may be forced to share the already insufficient assets with stockholders because apart from rehabilitation under that section they would suffer a worse fate, would disregard the standards of 'fair and equitable'; and would result in impairment of the Act to the extent that it restored some of the conditions which the Congress sought to ameliorate by that remedial legislation."

Neither does "continuity of management" constitute a justification for giving all of the new stock to the debtor. (*Los Angeles* case, p. 122.)

If the new lessee under the plan is "adequately financed," it is only because 78% of the financing, as a gift, is to come from the trust.

3 and 6. It is said that the certificate holders will have "far better security" if there is a future default by the new lessee (No. 3); and that "additional assets" will be added to the security for future defaults (No. 6).

#### What are the facts?

There is to be (a) a new chattel mortgage, (b) a liquidated damages provision and (c) a pledge of stock of the new company.

(a) The giving of the new chattel mortgage by the new company adds nothing to the balance sheet of the new company. It will secure only the future (and none of the past) lease indebtedness. The right to the use of the hotel

premises under the lease is a sufficient quid pro quo for obtaining the mortgage in order to secure payment of future rent.

It is said that "The entire existing security of the trustee (worth \$508,000) and the additional assets of the lessee (\$138,000) become security" under the new chattel mortgage and the stock pledge. But the trust right now is in the position, equitably, of *owner* of 78% of those assets because of the existing lease default. Is it "equitable" to require it to give up *ownership* of 78% in return for getting back a *lien* upon that 78%, plus a lien upon an additional 22%, as security for future indebtedness, when to acquire ownership of that additional 22% presupposes that the trust would incur a future rent loss in an equivalent amount? We submit, not.

(b) Nothing in the plan indicates how the amount of \$570,000 used in the liquidated damages provision was arrived at. It simply states: "In the event that the Lease, as modified, is terminated on account of the default of the lessee, the liquidated damages of the Trustee (the lessor) occasioned by such default and termination shall be and are hereby fixed at \$570,000" (R. 144). That sum amounts to the total for 3.25 years of the fixed rental of \$175,000 per year. It is very questionable that this is a provision for liquidated damages instead of an unenforceable provision for a penalty. It was held in *Miller v. Blockberger*, 111 O. S. 798, that—

"\* \* \* if there is such discrepancy between the sum stipulated and the damages which would probably and naturally result from the breach as to indicate that the sum stipulated could not have been arrived at by a process of computation and adjustment, or if arrived at by process of computation and adjustment such process did not have for its purpose compensation, but was arrived at for some purpose other than compensation, the sum will be held to be 'penalty' rather than 'liquidated damages.' " (Syllabus 1.)

See, also, *Jones v. Stevens*, 112 O. S. 43; *Norpac Realty Co. v. Schackne*, 107 O. S. 425.

But suppose the "liquidated damages" provision is good for its full amount of \$570,000, out of what property would it be collected? It is secured by the same chattel mortgage which is to secure future lease indebtedness—and \$508,000 of the property to be subjected to that mortgage equitably belongs to the trustee *right now*. So the result is that if there is deducted from the \$646,000 of assets with which the new enterprise is to begin, the \$508,000 now belonging to the trust, there is left only the \$138,000 being contributed by the debtor. That \$138,000 could not possibly be good for payment of the \$570,000 of "liquidated damages" even if it was not already security for future unpaid rent which easily could exceed \$138,000 in amount. On the basis of the capital assets of the new enterprise at the start, the notion that that amount could ever be collected as liquidated damages is illusory.

(c) With respect to the pledge to the trustee of the stock in the new company (R. 145), the analysis hereinbefore made with respect to the new chattel mortgage applies also to the proposed stock pledge. That stock will be endowed with a book value at the start in the amount of \$646,000 (less reorganization expenses), but \$508,000 of that value represents property to be contributed by the trust. To get a lien on the other 22% of the value of that stock (to insure payment of rent earned by granting the debtor the use of the hotel premises) is inadequate compensation for giving up the right to own outright 78% of the stock for contributing 78% of the capital on which it is based.

Concluding with respect to Nos. 3 and 6, we respectfully submit that an analysis shows that the "far better security" which the Court of Appeals said the trust would have under the plan is illusory and is not equivalent in value

to the 78% of the capital of the new enterprise which the plan requires the trust to donate to it.

4. Another "consideration" upon which the Court of Appeals relies is the debtor's agreement that a major portion (as it works out) of the net earnings of the new company from operation of the hotel is to be used to buy the beneficiaries' certificates. The result of such use of those net earnings is, if they become of sufficient amount, that the presently insolvent debtor will have built up its 22% contribution to the capital of the operating company into full ownership of the entire Hotel Cleveland site, building and chattels. In the meantime the fixed rent paid by the lessee is reduced each year by a percentage proportionate to the number of certificates so purchased from earnings.

The essence of this provision is that it appropriates for the use and benefit of the debtor the earnings from the 78% portion of the capital of the operating company which is contributed by the trustee. But those contributed assets are trust property, and their fruits equitably belong to the beneficiaries rather than to the debtor. That the debtor promises to use those earnings for the described purpose does not equitably justify diverting them for the benefit of the debtor either to purchase certificates or to purchase any other property desired by the debtor. As the plan works out, the percentage of earnings turned over to the trustee to buy certificates will never amount to as much as 78% of the earnings. It is more equitable and advantageous to the certificate holders that the earnings from their 78% of the capital be turned over to them *as earnings* rather than *as purchase price*, for thereby they not only receive a greater amount but also retain their investment in the trust.

5. The remaining "consideration" set forth in the opinion of the Court of Appeals is its statement, as follows: "It should be observed that, under the plan, none

of the trustee's securities passes either to the lessee-debtor or to the unsecured creditors." This is inaccurate. The trustee's security is its lien upon \$508,000 of chattel property which is to be "passed" free of that lien to the lessee-debtor's wholly-owned subsidiary. That is the equivalent of "passing" the security to the lessee-debtor itself.

We have analyzed one by one the "considerations" set forth in the opinion of the Court of Appeals as justifying the trustee in considering that there was "a fair and equitable consideration" for the sacrifices sought to be required of the certificate holders. We respectfully submit that both singly and collectively those so-called "considerations" fall far short of compliance with the full priority and equivalent participation requirements of what is "fair and equitable" and, therefore, that the plan in its present form should not have been confirmed.

### Point III.

The Circuit Court of Appeals erred in sanctioning the refusal to permit the petitioning land trust certificate holders and their Committee to intervene in the proceedings and in ruling that the certificate holders had no right to participate in what it called "the problem of adjustment."

The Court of Appeals ruled that it was not an "abuse of discretion" for the District Court to refuse to permit any of the petitioners to intervene generally in the reorganization proceedings, although they include the only individual owners and the only Committee who sought to intervene in these proceedings. (R. 830)

The Court of Appeals also took the position that the provisions of the trust indenture as to the powers of the trustee with respect to lease defaults frustrated any right which the certificate holders might otherwise have under the Chandler Act to participate in "the problem of adjustment" which it stated. (R. 835) But the certificate holders

have the largest present interest in the reorganization situation. Unless land trust certificate holders are to become "orphans" in such reorganization proceedings, at least as compared to stockholders and bondholders, certainly they should have the right to participate with respect to all matters which concern them.

We respectfully submit that the Court of Appeals erred in making those rulings.

#### **CONCLUSION.**

For the reasons set forth it is respectfully submitted that this case presents important questions of corporate reorganization law which were not decided by the Circuit Court of Appeals in accordance with the Chandler Act and applicable decisions of this Court; and that the case is one calling for the exercise by the Court of its supervisory powers, by granting a writ of certiorari and thereafter reviewing and reversing said decision.

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In the Supreme Court of the United States  
OCTOBER TERM, 1946  
**No. 448.**

IN THE MATTER OF  
VAN SWERENGEN CORPORATION,  
*Debtor,*  
and

THE CLEVELAND TERMINALS BUILDING COMPANY,  
*Subsidiary Debtor.*

THE CLEVELAND HOTEL PROTECTIVE COMMITTEE,  
J. C. LINCOLN, GORDON MACKLIN, ROBERT H. JAMISON,  
MELVIN B. HOTT AND ROY BRENHOLTS,  
Individually and as Members of said Committee,  
and

THE HENRY GEORGE SCHOOL OF SOCIAL SCIENCE,  
Intervening Petitioners,  
*Petitioners,*

vs.

THE NATIONAL CITY BANK OF CLEVELAND,  
Successor Trustee,  
and

THE CLEVELAND TERMINALS BUILDING COMPANY,  
*Respondents.*

IN PROCEEDINGS FOR THE REORGANIZATION  
OF A CORPORATION.

ON PETITION FOR WRIT OF CERTIORARI  
TO THE UNITED STATES CIRCUIT COURT OF APPEALS,  
FOR THE SIXTH CIRCUIT.

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**REPLY BRIEF OF PETITIONERS.**

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## REPLY BRIEF OF PETITIONERS.

We shall for the purposes of reply thereto group the contentions in the briefs of the debtor (Cleveland Terminals Building Co.) and of the trustee (National City Bank

of Cleveland, Trustee), under the three main points set forth in our petition and main brief.

### Point I.

**It is essential to confirmation of the plan that it be "fair and equitable" to the land trust certificate holders within the meaning of the Chandler Act, even though integrated into the plan are provisions for lease adjustment.**

The first issue is whether the instant reorganization plan, promulgated by virtue of the Chandler Act, is exempt from compliance with Section 221(2) thereof requiring a judicial finding that

"(2) The plan is fair and equitable \* \* \*."

May it be confirmed in the absence of a judicial determination that the plan is, as a matter of law, "fair and equitable" as to the land trust certificate holders?

Both the debtor and the trustee contend the above question should be answered in the affirmative. Their contention necessarily amounts to the position that Section 221(2) affords no protection to the land trust certificate holders, that such a judicial determination is unnecessary (and therefore uncalled for and improper), and *that this kind of a plan can be confirmed even though it is unfair and inequitable to the land trust certificate holders, if the trustee approves the plan.* Indeed, that seems to be the view also of the court below. (R. 835-836.) Of course it follows that if no judicial determination that the plan is "fair and equitable" as to the land trust certificate holders is necessary, then petitioners have no case. We are confident, however, that that is not the law.

Both the debtor and the trustee contend that the decision of the Court in the Milwaukee case (*Group of Investors v. Milwaukee R. Co.*, 318 U. S. 523, 546) justifies exempting this plan from Section 221(2). In addition the debtor

argues that the land trust certificate holders as beneficiaries own "no part" of the property involved, that they have only a claim against the trustee for the net income from the trust (Debtor's brief, 7-10), and finally that petitioners as beneficiaries "have no right to be heard here at all, and that should be the end of the matter." (Debtor's brief, 13.)

### 1.

The plan does *not* involve simply what respondents call "an adjustment of the lease." *Inseparably integrated into the plan are provisions affecting property rights of the beneficiaries.* The plan involves a method of acquiring ownership of the trust corpus and ownership of the beneficiaries' interest. When the respondents talk about "the treatment" of the debt of \$1,100,000 by wiping it out they are talking about the disposition of trust property of which the beneficiaries are the equitable owners. The proposal to cancel the chattel mortgage security of \$508,000 would work a disposition of trust property in which the beneficiaries have an equitable ownership. It is in equity the beneficiaries' property, not the trustee's. The plan is in essence one for the liquidation of a trust asset and of the trust, and the amended lease to the debtor's new subsidiary is simply incidental to those objects. The beneficiaries, in short, have definite equitable property rights in the property. In *Case v. Los Angeles Lumber Co.*, 308 U. S. 106, at 114, the Court held that "*All those interested in the estate* are entitled to the court's protection." We are confident that the land trust certificate holders here are entitled to protection under Section 221(2) of the Chandler Act, and that the plan must judicially be found to be "fair and equitable" as to the certificate holders before it can be confirmed, notwithstanding whatever percentage of certificate holders may have been induced by the high-pressure campaign of the trustee to execute consents to the plan. See *Case v. Los Angeles Lumber Co.*, 308 U. S. 106, at 114.

Both respondents rely upon the *Milwaukee* case (318 U. S. 523, at 546) as exempting the land trust certificate holders from the benefit of the "fair and equitable" requirement. Both the debtor (Brief, 12) and the trustee (Brief, 11) quote from that part of the opinion in the *Milwaukee* case wherein, with respect to whether or not the plan in that case was fair and equitable, the court pointed out:

"The short answer to that objection is that the Terre Haute properties have not been treated by the Commission or the District Court as a part of the properties of the debtor for reorganization purposes. \* \* \* The commission and the District Court considered the problem solely as one of rejection or affirmation of a lease." (318 U. S. 543, 546-547)

However in the instant case the plan itself treats the hotel property as if it *were* an asset of the debtor and the rights of equitable ownership of the beneficiaries in the premises as if they were only liabilities of the debtor—just the opposite of what the Court stated above with respect to the Terre Haute properties in the Milwaukee plan. Turning to Article I of the General Plan of Reorganization of the Building Company (an unnumbered physical exhibit), at page 4 thereof, it is stated as follows:

*"Assets of The Cleveland Terminals Building Company.*

"The assets of The Cleveland Terminals Building Company consist principally of land, building sites, buildings and leasehold interests situated mainly in the area immediately south and west of the Public Square in the City of Cleveland, Ohio. It *owns* and operates the Terminal Tower, and the *Cleveland Hotel*, Republic, Builders' Exchange, Garage and Midland buildings \* \* \* these buildings were carried on the books of the company at \$29,544,914.56, representing their cost \* \* \*."

At pages 6 and 7 of the General Plan the land trust certificates are treated simply as liabilities of the debtor, and the plan refers to them as follows:

*"Liabilities of The Cleveland Terminals Building Company.*

"The liabilities of The Cleveland Terminals Building Company, including for the purposes of this statement certain certificates hereinafter described in paragraphs 1 and 4, consist of the following: \*\*\*

"4. Fee ownership certificates representing 7,000 shares of equitable ownership in a portion of the premises known as the Cleveland Hotel building site and certain adjoining property, leased to The Cleveland Terminals Building Company under Indenture of Lease dated April 1, 1927, from The Guardian Trust Company, Trustee (The National City Bank of Cleveland, Successor Trustee)." etc.

Thus, contrary to the treatment of the Terre Haute properties in the Milwaukee plan, the main plan in the instant case *does* treat the Cleveland Hotel properties as part of the properties of the debtor for reorganization purposes. For this reason, as well as for the other reasons above set forth, the factual situation presented here is different from that in the *Milwaukee* case with respect to the Terre Haute properties.

2.

The debtor (but not the trustee) argues that the equitable ownership of the land trust certificate holders is not an interest in the property being disposed of by the reorganization plan, that a certificate holder "owns no part of that leasehold," that (instead of a property interest) a certificate holder has only a claim against the trustee. (Debtor's brief, 7.) Further developing that thesis the debtor cavalierly asserts that the land trust certificate holders "have no right to be heard here at all" (Debtor's brief, 13) and that "An order permitting them (certificate holders) to intervene generally would have been erroneous." (Debtor's brief, 10.) These arguments all have for their basis the assumption that the trust beneficiaries have

only an *in personam* claim against the trustee for a share of the net income and that the beneficiaries do not have any ownership interest in the trust corpus itself. If it is true that the trust beneficiaries lack any ownership interest or are otherwise not parties affected by the plan—and if the trust beneficiaries have no right to be heard in the reorganization court—then petitioners have no case here for relief. But the debtor's contentions are unsupportable.

Do the land trust certificate holders, as trust beneficiaries, have only a chose in action against the bank trustee, or do they have an equitable interest in the property itself?

In *Senior v. Braden*, 295 U. S. 422,—the only case in this Court we can find involving land trust certificates—the question was whether land trust certificates, with respect to land "some within Ohio, some without," were taxable as personal property by Ohio. It was held that the land trust certificates did not represent merely a chose in action against the trustee but that the beneficiaries had an interest in the trust land itself.

The trust indentures in the *Braden* case, which were quite similar to the trust instrument here, included provisions described by the Court (295 U. S., at p. 430) as follows:

"In each declaration the Trustee undertakes to hold and manage the property for the use and benefit of all certificate owners; to collect and distribute among them the rents; and in case of sale to make *pro-rata* distribution of the proceeds. While certificates and declarations vary in some details, they represent beneficial interests which, for present purposes, are not substantially unlike. Each trustee holds only one piece of land and is free from control by the beneficiaries. They are not joined with it in the management."

To show that the argument made now by the debtor is essentially the same as the argument made by the State

of Ohio in the *Braden* case, we quote the following parts of those two arguments:

*Argument of Debtor in This Case*

"The certificate holder owns no part of that leasehold. What the certificate holder has is a right to the aliquot share of the income that remains to the landlord after the latter has paid the expenses." (Debtor's brief, 6.)

*Argument of State of Ohio in Braden Case*

"The State maintains, that \* \* \* 'The rights of the beneficiary consist merely of claims against the various trustees to the *pro rata* distribution of income, during the continuance of the trusts, and to the *pro rata* distribution of the proceeds of a sale of the trust estates upon their termination.' " (295 U. S., 430-431.)

In rejecting that argument in the *Braden* case, the Court through Mr. Justice McReynolds stated (295 U. S., pp. 432-433) as follows:

"In *Brown v. Fletcher*, 235 U. S. 589, 597, 599, we had occasion to consider the claim that a beneficial interest in a trust estate amounts to a chose in action and is not an interest in the *res*, subject of the trust. Through Mr. Justice Lamar we there said:

"\* \* \* In either case, and whatever its form, trust property was held by the Trustee,—not in opposition to the *cestui que trust* so as to give him a chose in action, but—in possession for his benefit in accordance with the terms of the testator's will. \* \* \*

"The beneficiary here had an interest in and to the property that was more than a bare right and much more than a chose in action. \* \* \*

"The doctrine of *Brown v. Fletcher* is adequately supported by courts and writers. \* \* \* We find no reason for departing from it."

In *Blair v. Commissioner*, 300 U. S. 5, 13, holding that for income tax purposes the transfer of the beneficial interest in a testamentary trust vested the assignee with an equitable interest in the trust property, Mr. Chief Justice Hughes stated (p. 13):

"The will creating the trust entitled the petitioner during his life to the net income of the property held in trust. He thus became the owner of an equitable interest in the corpus of the property. *Brown v. Fletcher*, 235 U. S. 589, 598, 599; *Irwin v. Gavit*, 268 U. S. 161, 167, 168; *Senior v. Braden*, 295 U. S. 422, 432, 433; *Merchants' Loan & Trust Co. v. Patterson*, 308 Ill. 519, 530; 139 N. E. 912. By virtue of that interest he was entitled to enforce the trust, to have a breach of trust enjoined and to obtain redress in case of breach. The interest was present property alienable like any other, in the absence of a valid restraint upon alienation. *Commissioner v. Field*, 42 F. (2d) 820, 822; *Shanley v. Bowers*, 81 F. (2d) 13, 15. The beneficiary may thus transfer a part of his interest as well as the whole. See *Restatement of the Law of Trusts*, Sections 130, 132 *et seq.* The assignment of the beneficial interest is not the assignment of a chose in action but of the 'right, title and estate in and to the property.' *Brown v. Fletcher*, *supra*; *Senior v. Braden*, *supra*. See *Bogert, 'Trusts and Trustees,' Vol. 1, Sec. 183, pp. 516, 517*; 17 *Columbia Law Review*, 269, 273, 289, 290."

Thus the interest of the land trust certificate holders in the Cleveland Hotel premises, and in the \$508,000 of mortgage security, and in the lessor's interest in the lease, is that of *equitable ownership of those properties*. It is *their* investment. They—and not the trustee—are the real parties in interest and equitably the real owners of those properties. *We respectfully submit that theirs is an interest intended to be within the protection of Section 221(2) of the Chandler Act.*

We submit, therefore, that the land trust certificate holders *are* entitled to be treated fairly and equitably in the reorganization court; and that Section 221(2) of the Chandler Act is not rendered inapplicable because *part* of the plan includes proposed changes of the lease of the trust corpus.

**Point II.**

The plan is not "fair and equitable" with respect to the land trust certificate holders in that it fails to give the creditor trustee its right of full priority and a participation in the new company equivalent to its contribution thereto.

Looking behind the scenes, it is true, as the debtor emphasizes (Debtor's brief, 2, 23) that "The Cleveland Terminals Building Company" "no longer represents the interests of the original beneficial owners \* \* \*; but *it now represents the interests of the former unsecured creditors of that corporation, who have now become its stockholders and owners.*"

No one ever knew how bankrupt the debtor was. It had general unsecured claims somewhere above \$55,000,000 and assets somewhere below 10% of that amount.<sup>1</sup> The debtor (Cleveland Terminals Building Co.) was hopelessly insolvent and all of its stock was "washed out" in the proceedings.<sup>2</sup>

---

<sup>1</sup> The District Court made the following finding:

"(d) That the general unsecured claims filed and allowed in the estate of Subsidiary Debtor exceed the sum of \$55,000,000.00 as above set forth and that the assets, including property and value in excess of valid liens or pledges thereon, do not presently, and before depreciation, exceed 10% of such indebtedness; that Subsidiary Debtor is therefore insolvent; and accordingly that Van Sweringen Corporation, Debtor herein, and owner of all of the stock of The Cleveland Terminals Building Company, Subsidiary Debtor herein, has no interest in its capacity as a stockholder of Subsidiary Debtor and that its acceptance of the Plan in that capacity is therefore not required." (R. 728.)

<sup>2</sup> In the General Plan of Reorganization of the Building Company (a physical exhibit) in Article I, at page 2, it is set forth:

"The shares of stock of The Cleveland Terminals Building Company (all of which are held by Van Sweringen Corporation through its Trustees appointed in these proceedings), no longer represent any claim or interest in the property of The Cleveland Terminals Building Company, and therefore no provision is made for the holders of such stock in this Plan."

*The significance of those facts is, that the plan involves in reality a disposition and liquidation of assets in bankruptcy, more than relief and resuscitation of the business enterprise of the former owner of the corporate debtor.* The "management structure" which the debtor argues would be preserved by the plan (Debtor's brief, 24) has already been demolished. As the debtor points out, the term "Subsidiary Debtor" now stands for the former unsecured creditors. **So the two groups interested in the personal property assets of the Cleveland Hotel are (a) on one hand the unsecured creditors, who have a claim upon \$138,000 of its property, and (b) on the other hand the land trust certificate holders who through their trustee are equitable owners of the remaining \$508,000 of its property by reason of the defaulted chattel mortgage owned by the trust.**

The case is thus reducible to the following situation:

The insolvent corporate debtor has \$138,000 of personal property assets which belong to the \$55,000,000 of unsecured creditors. It also has mortgaged personal property of \$508,000 which belongs equitably to the trust beneficiaries. It has no equity in its lease. Its stock is without value and its stockholder's interest has been wiped out.

The assets of \$646,000 are to be transferred to a new company, freed of the unsecured creditors claims of \$55,000,000 and freed of the trust mortgage claim of \$1,100,000. In order to set those transferred assets to work, the defaulted hotel lease is to be revived, amended and continued, with a new corporation as lessee and operator of the hotel thereafter. *In short, the new company is in substance a new enterprise and is to be the result of the contributions to its capital made by the unsecured creditors (\$138,000) and the certificate holders (\$508,000).* It is at that point that the unfairness and inequitableness of the plan comes in; that the certificate holders are denied in the new company their right of full and absolute priority in

*assets and earnings*; that the certificate holders are denied a participation in the new company equivalent to their proportionate contribution to its capital; that the general creditors, at the expense of the certificate holders, and out of rights which fairly and equitably belong to the certificate holders, are given a participation far beyond their proportionate contribution to the new enterprise, and that the equivalent contribution rule is flagrantly violated.

While the certificate holders are to contribute 78% (\$508,000) of the capital of the new company and the unsecured creditors are to contribute only 22% (\$138,000) thereof, the unsecured creditors are to receive 100% of the stock of the new company—*all of its equity interest*. It is a flagrant case of giving one creditor group (the unsecured creditors) an undeserved, unfair and inequitable preferred treatment over another creditor group (the certificate holders); and that distribution of the interest in the new enterprise definitely is to the detriment of, and is carved out of the rights which should belong to, the certificate holders.

Neither the debtor nor the trustee has made any attempt to answer the question: Why is it "fair and equitable" that the certificate holders should contribute 78% of the assets of the new company and the unsecured creditors only 22% thereof, yet the unsecured creditors are to receive all of the equity in the new company and in addition will immediately become the owners of 78% of the capital contributed thereto by the certificate holders?

To divert attention from the question of why the unsecured creditors' contribution of 22% should entitle them to 100% of the equity interest, both the debtor and the trustee argue that the certificate holders will acquire *future* benefits from the lease to the new company. We dispute the importance of those so-called benefits; but assuming for the sake of argument that they are important, that still does not answer the question: Why does the 22% investment of the unsecured creditors, as against the 78% in-

vestment by the certificate holders, entitle the unsecured creditors to all of the equity in the new enterprise? *What have the unsecured creditors given to justify that? The issue is not alone one of what the trust gets, but also is: What have the unsecured creditors given for what they are to get?*

If the old stockholders of the lessee debtor wanted to come back into the situation, it is settled that they would have to make a fresh contribution and that the participation to be accorded the old stockholders would not be in excess of their contribution in money or in money's worth to the new enterprise.<sup>3</sup>

The rule limiting the participation in a new company of the old stockholders of an insolvent corporation to a participation not more than is reasonably equivalent to their contribution in money or in money's worth, applies with equal force, it is submitted, to the participation in the new company to be accorded one creditor as against another creditor. *Judged by the equivalent contribution rule, it is unfair, inequitable and constitutes unwarranted preferred treatment to bestow 100% of the stock of the new company on the unsecured creditors, instead of dividing that stock in the ratio of 22%-78% in accordance with the respective contributions of the capital made by the unsecured creditors and the certificate holders.*

So in the first place, the plan is unfair and inequitable because it gives to the unsecured creditors (the Building Company), immediately, the 78% of capital assets, valued at \$508,000, contributed by the certificate holders (through their trustee).

<sup>3</sup> In *Case v. Los Angeles Lumber Co.*, 308 U. S. 106, at page 122, Mr. Justice Douglas stated:

"In view of these considerations we believe that to accord 'the creditor his full right of priority against the corporate assets' where the debtor is insolvent, the stockholder's participation must be based on a contribution in money or in money's worth, reasonably equivalent in view of all the circumstances to the participation of the stockholder."

Equitable distribution of the capital stock of the new company on a 22%-78% basis, in accordance with the 22%-78% capital contributions, would necessarily carry with it a 22%-78% division of the earnings of the new enterprise. The certificate holders in that case would be entitled as of right to 78% of the earnings, as *earnings*. Bearing in mind that the certificate holders should equitably already be entitled under the plan to 78% of the earnings, it immediately becomes apparent how flimsy is the argument of the trustee that the unsecured creditors are giving up something to the certificate holders (a) because at the start of the plan (but not after there are less than 7,000 certificates outstanding) 50% of the net earnings would go to the certificate holders as additional rent, (b) because the other 50% of the net earnings would be used to buy up the trust certificates for the benefit of the unsecured creditors, and (c) because dividends payable to the unsecured creditors on the new stock will be postponed until the earnings have been sufficient to retire one-half of the certificates (Trustee's brief, 17, 18).<sup>4</sup>

The certificate holders, in accordance with their capital contribution, should be entitled to 78% of the net earnings, and not to a maximum of 50%; and the certificate holders are entitled to receive those earnings as *earnings*, instead of having the income from their own property used to buy out their certificates.

A further word about the additional rental which at its maximum of 50% still amounts to less than 78% of such earnings:

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<sup>4</sup> The trustee almost frantically reiterates that the unsecured creditors (the Building Company) derive no income *in cash* from their 100% stock ownership until after the earnings have retired one-half of the trust certificates—it refers to that fact *eight* times at pages 18-21 of its brief. The fact is that the unsecured creditors are receiving earnings every time a certificate is purchased, for such purchase constitutes an investment of the earnings in the purchase of part of the hotel premises. They are simply receiving the benefit of those earnings *in property* instead of *in cash*.

(a) When there are 7,000 certificates outstanding, the yearly earnings before payment of fixed rent are to go as follows: (1) \$175,000 for fixed rent, (2) 50% of the net earnings remaining thereafter go to the certificate holders as additional rent, and (3) the other 50% of the net earnings are used to buy out certificates. *As fast as each of the 7,000 certificates are thus retired, both the fixed rent of \$175,000 and the 50% of the net earnings payable as additional rent for the next year are reduced by 1/7000th for each retired certificate.* It begins to snowball. (The certificate holders thus bought out will never share in any additional rentals, nor, of course, in any further earnings.)

(b) When there has been a reduction to 5,000 certificates, (1) the fixed rental then becomes 5000/7000ths of \$175,000, or only \$125,000 a year, (2) the proportion or net earnings going as additional rental drops to 5000/7000ths of 50% of the net earnings, so now only 35.7% of the net earnings go as additional rent, and (3) the remaining portion of the net earnings, 64.3%, are invested for the Building Company in the purchase of trust certificates. As both the debtor and the trustee point out, the operation of the hotel during the war years has resulted in a substantial profit, so that *a substantial number of certificates will be immediately retired if the plan goes into effect.*

(c) When the certificates have been reduced to 3,500, or half of their present number, a number of things will happen:

- (1) The fixed rental becomes \$87,500 per year, or one-half of what it is at the start of the plan.
- (2) The lessee thereafter pays only 25% of the net earnings as additional rental. (R. 137.)
- (3) The lessee thereafter uses only 25% of the net earnings to buy in certificates. (R. 138-139.)
- (4) The pledge of the new company's stock is ended and it gets it back. (R. 146.)

- (5) The lessee retains 50% of the net earnings thereafter.

That is how the plan works. **The key to it is that it appropriates the bulk of the earnings of the new company for use in buying out the trust certificates for the benefit of the unsecured creditors (the Building Company), to the end that the unsecured creditors may ultimately become the owners of the entire premises, "lock, stock and barrel."** Earnings which should belong to the certificate holders in their own right are thus to be used to buy out their interest (**not the unsecured creditors' interest**).

The portion of the net earnings going to the trustee as additional rent at no time amounts to 78% and is never higher than 50% and immediately (upon the initial retirement of certificates) drops downward. It is therefore simply not true that the plan gives the certificate holders "an equitable participation in the earnings" for it never amounts to 78% thereof. On the other hand the plan gives the unsecured creditors (the Building Company) an unfair and inequitable participation in the earnings in that for their 22% capital distribution they receive as their share of the earnings an amount upward from 50% to 100% thereof.

Both the debtor and the trustee present computations setting forth what the certificate holders would receive under the plan with respect to the first 18 months of its operation. (Trustee's brief, 19-21; Debtor's brief, 19-20.) The trustee states that those net earnings were \$553,400, of which \$276,700 would go as additional rent; the debtor's figure is \$272,553. Taking the trustee's figure of \$553,400, the trustee fails to point out that if the certificate holders are given their proper 78% share of the earnings they would receive not \$276,700 but \$431,651,—which is quite a difference, \$154,952. So on the basis of the trustee's own figures for the first 18 months of the operation under the plan, \$154,952 of the earnings would be taken from the

certificate holders and applied for the benefit of the unsecured creditors (the Building Company), which would immediately more than completely repay them for their initial investment of \$138,000 in the enterprise. To say that the plan is "very favorable" to the certificate holders is therefore to be blind to the fact that it robs them of their right to 78% of the *earnings*, as well as robs them of their ownership of 78% of the *capital assets* of the new company.

We earnestly submit, therefore, that the plan is unfair and inequitable to the land trust certificate holders for it deprives them of their equitable right to 78% of the capital stock and the earnings of the new company for their contribution of 78% of the capital and instead, at the expense of the certificate holders, immediately gives the unsecured creditors (the Building Company) 100% of the capital assets of the new company (as represented by the new stock), and thereafter gives the unsecured creditors an inequitable share upward from 50% to 100% of the earnings from the joint contribution of capital made by the certificate holders and the unsecured creditors. It does violence to the rule enunciated in *Case v. Los Angeles Lumber Co.*, 308 U. S. 106, that participation must be commensurate with the contribution made in money or in money's worth. It constitutes a departure from the decisions of this Court from *Northern Pacific Ry. Co. v. Boyd*, 228 U. S. 482, to *Case v. Los Angeles Lumber Co.*, 308 U. S. 106, and *Consolidated Rock Co. v. Dubois*, 312 U. S. 510. Yet it has been sanctioned by the Sixth Circuit Court of Appeals. It is not only unfair and inequitable in this case, but, unless modified by this Court, will stand as a dangerous precedent in future reorganization cases.

The situation is *not* one of "demolishing the existing management structure," as the debtor says (Brief, 24). *That structure no longer exists anyhow.* It was based upon the ownership of all of the stock of the debtor (the Building

Company) by the principal debtor, Van Sweringen Corporation, and ended when all of the stock of the debtor was given by the plan to its unsecured creditors. The certificate holders (through the trustee) for their 78% contribution to the capital of the new company are entitled, through stock ownership, to a 78% voice in the management of the new company, instead of giving to the unsecured creditors (through the Building Company) a 100% voice in the management in return for their 22% contribution. Likewise the case is not one of benevolently permitting the owner of the debtor (the Building Company) at the time the reorganization petition was filed, "an opportunity eventually to earn the right to own the property" (See Debtor's brief, 17); for, as the brief of defendant itself concedes (p. 2), "The term 'Subsidiary Debtor' \* \* \* now represents the interests of the former unsecured creditors of that corporation, who have now become its stockholders and owners." Instead, it is a case, if the plan remains unmodified, of giving the unsecured creditors an excellent speculative chance, through ownership of the equity in the new company, of owning the property of the certificate holders, and, indeed, of giving the unsecured creditors to start with a gift of \$508,000 of the certificate holders' property.

Upon recognition of the fact that the plan should provide a treatment of the certificate holders equal with that given the unsecured creditors as to the equity in the enterprise and therefore that the equity in the enterprise should be divided 78% to the certificate holders and 22% to the general creditors, the modification necessary to make the plan fair and equitable is simple. All that is required is an order directing that approximately 78% of the stock of the new company be distributed to the trustee for redistribution among the certificate holders, and that the remaining 22% of the stock be distributed to the unsecured creditors (the Building Company). That would constitute, and only that

would constitute, a fair division of the ownership of the capital and the earnings of the new enterprise.

The trustee, notwithstanding its active advocacy and support of the position of the debtor in this litigation is scarcely in a position to oppose that modification.

The brief on behalf of the Building Company (the unsecured creditors) expressly states that the new lease is "fair." It calls it "*A fair* new lease." (Debtor's brief, 24.) Upon a redistribution of the 78% block of the stock among the certificate holders at the rate of, say, one share of stock for each certificate, the certificate holders will then be possessed of their rightful equity in the new company in recognition of their 78% contribution to its capital, just as the unsecured creditors (through the Building Company) will be possessed of 22% of that stock for their 22% contribution to the new company's assets. Thereafter, as the certificates are retired from the earnings of the enterprise, the certificate holders will, through their ownership of one share of stock per certificate, retain their equity in the enterprise.

No other modification of the plan than the foregoing is necessary under the circumstances in order to make it fair and equitable, and to be worthy of confirmation. Clearly the courts have jurisdiction to so modify the plan, both under the Chandler Act and under Article VIII, Section VIII (pp. 45-46), of the General Plan of Reorganization of the Building Company. Clearly, fairness and equity to the land trust certificate holders require that the plan be so modified.

**Point III.**

The Circuit Court of Appeals erred in sanctioning the refusal to permit the petitioning land trust certificate holders and their Committee to intervene in the proceedings and in ruling that the certificate holders had no right to participate in what it called "the problem of adjustment."

If the land trust certificate holders are not entitled to be protected in a reorganization court against a plan which is not "fair and equitable" as required by Section 221(2) of the Chandler Act, then they have not been prejudiced by the refusal of the District Court to permit petitioners to intervene for they would have no rights in that court anyhow. We submit, however, that petitioners did have rights which were entitled to be protected in that reorganization court and that they were entitled to be admitted as parties in that court in order to assert and properly defend those rights. No one else was there asserting those rights on petitioners' behalf—even their trustee was committed from the start to acceptance of the plan for reasons which on the surface we cannot understand. And obviously the corporate debtor (which is now a front for the unsecured creditors) was eager to have the plan approved. In short no *official* opposition to the plan was permitted. Judicial discretion must always be exercised with reference to the facts upon which it is based. It clearly was an abuse of discretion to exclude all land trust certificate holders as parties. The right to be heard in opposition to confirmation of the plan carries with it the right to seek a review of such confirmation by appeal. Prejudice from that ruling arises where in consequence of that wrongful refusal the certificate holders are prevented from appealing and a plan which is unfair and inequitable as to them is permitted to remain confirmed. If, therefore, the plan is unfair and inequitable as to the certificate holders, as petitioners contend, the denial to them of the right to

appeal establishes the existence of prejudice from such erroneous ruling.

### **CONCLUSION.**

For the reasons set forth in petitioners' petition, main brief and this reply brief, we respectfully submit that the Circuit Court of Appeals has erred in its decision in this case, that it has both "decided a Federal question in a way probably in conflict with applicable decisions of this Court" and has "decided an important question of Federal law which has not been, but should be, settled by this Court"; and that the case is, therefore, one calling for the granting of a writ of certiorari and thereafter reviewing and either reversing or modifying said decision in the respects hereinabove contended.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1946.

No. 448.

IN THE MATTER OF  
VAN SWERINGEN CORPORATION,

*Debtor,*

and

THE CLEVELAND TERMINALS BUILDING COMPANY,  
*Subsidiary Debtor.*

THE CLEVELAND HOTEL PROTECTIVE COMMITTEE,  
J. C. LINCOLN, GORDON MACKLIN, ROBERT H. JAMISON,  
MELVIN B. HOTT AND ROY BRENHOLTS,  
Individually and as Members of said Committee,  
and

THE HENRY GEORGE SCHOOL OF SOCIAL SCIENCE,  
Intervening Petitioners,  
*Petitioners,*

vs.

THE NATIONAL CITY BANK OF CLEVELAND,  
Successor Trustee,  
and

THE CLEVELAND TERMINALS BUILDING COMPANY,  
*Respondents.*

IN PROCEEDINGS FOR THE REORGANIZATION  
OF A CORPORATION.

BRIEF OF THE CLEVELAND TERMINALS  
BUILDING COMPANY OPPOSING PETITION  
FOR WRIT OF CERTIORARI.

I. STATEMENT OF FACTS.

The statement of facts in the petition omits or glosses over facts which are of controlling importance. Of these, perhaps the most important are

- (a) the fact that the Agreement and Declaration of Trust (R. 102, 639) by which the rights of the certificate holders are established vests the entire control and management of the trust property in the Trustee—one of the respondents in this case;
- (b) the fact that the Subsidiary Debtor's interest in the hotel was, and is, a leasehold estate, and that the interests of the Subsidiary Debtor on the one hand and of the certificate holders on the other pertain to entirely different subject matters—the certificate holders' interests, to the reversionary estate, and the Subsidiary Debtor's interest to the leasehold estate.

The significance of these and other glossed over or omitted facts, will be developed in our brief at the points where they become material.

## **II. THE PARTIES.**

The term "Subsidiary Debtor" no longer represents the interests of the original beneficial owners (the corporation was found to be insolvent); but it now represents the interests of the former unsecured creditors of that corporation, who have now become its stockholders and owners, seeking to recoup a fraction of their losses by rejuvenating the equities which may remain to them in the Company's building units. Hence the terms "Subsidiary Debtor," and "Building Company," as used throughout this brief, must be understood as being merely a convenient way of designating that great group who were originally the unsecured creditors.

The respondent Subsidiary Debtor is the lessee under the lease creating the leasehold estate which is the subject of this controversy.

The respondent Trustee (The National City Bank of Cleveland, Successor Trustee) is now the lessor under said

lease, and as such is the holder of the reversionary estate, for the benefit of the certificate holders.

The petitioners are certificate holders, most of whose certificates were purchased—"probably at distress prices," (R. 81)—during the reorganization and *after* the Hotel Plan was submitted to the certificate holders (R. 12, 13, 20, 68). Their beneficial interests are interests in the reversionary estate—not in the leasehold estate.

In the caption, the petitioners denominate themselves as "Intervening Petitioners." This is a misnomer; for the Committee has never been allowed to intervene on any question, and the limited intervention that was allowed to Mr. Hott and the School was restricted to a question of fact that is not now before this Court.

### III. HOW THE CASE AROSE.

The Subsidiary Debtor was the owner of four large building units in the heart of the business section of Cleveland—the Terminal Tower, a department store building, a group of three large office buildings, and the Cleveland Hotel. The reorganization plan had separate sections for each of the four units, with a provision that they might be separately confirmed and separately consummated. This has been done as to all of the units except the Hotel. The present appeal relates only to the Hotel.

Three issues were presented to the Courts below:

- (1) A question as to whether there was an abuse of discretion in refusing to permit a general intervention.
- (2) A double question of fact relating to the Trustee's acceptance—was there a sufficient number of consents to the Plan, and were they obtained by fraud?
- (3) A double question of law and fact relating to the Plan—do the principles of priority stated in *Case*

*et al. vs. Los Angeles Lumber Products Co., Ltd.*,  
(1939) 308 U. S. 106 apply, and is the Plan fair  
and equitable?

On the question of intervention, the Special Master and the Trial Court had allowed petitioners to present all the evidence and make all the arguments they desired (R. 81, 830); but had refused general intervention to avoid potential claims of committees for allowance of compensation (R. 81). It is obvious that there was no prejudice to petitioners, and no abuse of discretion.

Likewise in the Court of Appeals, the petitioners were accorded a full and complete hearing, even though intervention had been denied.

On the questions of fact as to the number of consents to support the Trustee's acceptance, and the alleged fraud in obtaining them, the facts were found against Petitioners; and questions of fact are not reviewable here. This the Petitioners admit; and so they do not present in this Court any issues on the validity of the acceptance. (Petition, p. 7.)

On the question of law as to the applicability of the priority principles of the *Los Angeles* case, the Court of Appeals held them inapplicable where, as here, priority of claim or interest is not a factor; but the Court also found that for the proposed amendment of the lease, and the ancillary exchange of the back rent claim for stock and money, there is "a *fair and equitable* consideration" to the Trustee for the beneficiaries. That conclusion would have been the ultimate goal to reach even if the *Los Angeles* case had been applicable.

#### IV. SUMMARY OF ARGUMENT.

##### A. Petitioners Are Not Properly in Court on this Question.

Admittedly the petitioners are neither creditors nor stockholders (petition, p. 8) and have no right to be heard, or to appeal, as such. Sec. 206.\* They may be heard on appeal only if they have been allowed to intervene.

However, the Committee was not allowed to intervene at all; and Mr. Hott and the School were allowed to intervene only on the questions of fact—the number of consents, and whether they were fraudulent. Those questions of fact are not before this Court, and on the questions which *are* before this Court, no intervention has been allowed to anyone. Hence, the petitioners are not properly in Court on this appeal.

##### B. Status of the Parties.

The petitioners are not in a creditor-position, and they have no interest in the leasehold estate which is the subject of this litigation. Their only interests are in the *reversionary* estate; and in acquiring those, they vested absolute control in the Trustee.

##### C. The Adjustment of the Leases in the Reorganization.

Priority of claims is not involved here—leases are. The proposed transaction is therefore governed by the lease readjustment principles of *Group of Institutional Investors, et al. vs. Chicago, Milwaukee, St. Paul and Pacific Railroad Company* (1943) 318 U. S. 523, and not by the absolute priority rule of *Case et al. vs. Los Angeles Lumber Products Co., Ltd.* (1939) 308 U. S. 106.

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\* Sec. 206 provides in part:

"The debtor, the indenture trustees, and any creditor or stockholder of the debtor shall have the right to be heard on all matters arising in a proceeding under this chapter."

**D. Even Under the Rule of Absolute Priority the Plan is Fair and Equitable.**

The advantages gained by the Lessor under the proposed lease are so great as amply to justify the sacrifices required by the Plan, including the removal of the back rent claim from the list of items entitled to the doubtful and partial security of the existing chattel mortgages, and the exchange of such back rent claim for the money and shares of the reorganized Subsidiary Debtor on the same basis as that allowed by the Plan to unsecured creditors. The Plan is therefore fair and equitable under either test—that of the *Los Angeles* case or that of the *Chicago, Milwaukee, St. Paul & Pacific Railroad Company* case.

**V. ARGUMENT.**

**A. Petitioners Are Not Properly in Court on This Question.**

The Courts below permitted no intervention at all for the Committee. For Mr. Hott and the School, the Courts permitted intervention only on the question of acceptance (R. 86). Hence none of the petitioners are properly in court on this question of confirmation, and they have no right to be heard here on this subject. Such right could be acquired only by a ruling of this Court that Judge Jones had been guilty of an abuse of discretion in denying general intervention. Hence the petitioners' brief covering the subject of the fairness and equity of the Plan, should be considered only on the hypothetical basis of what the Court would do with that subject were the parties properly in Court thereon.

On this hypothetical basis both the Special Master and the Trial Judge permitted all the relevant evidence on the subject of confirmation that would have been permitted had the objectors actually been creditors, and they patiently heard all the arguments that were offered on that question. Petitioners have briefed the case here as though intervention had in fact been granted, instead of denied, to them.

Accordingly, we shall here present the arguments that would have been appropriate if intervention had been granted; but we shall do so only on the basis of that contrary-to-fact assumption.

### B. Status of the Parties.

In the preceding paragraphs, we have referred to the petitioners' first false assumption, to wit:—that they are properly before the Court on the question of confirmation of the Plan.

Throughout the argument of petitioners runs a second false assumption—to wit, that the certificate holders are essentially creditors of Subsidiary Debtor, holding a senior lien upon its property. The fact is, of course, that they are merely beneficiaries of a trust where the Trustee is in a lessor-position—a lessor having a reversionary estate and a claim for delinquent rent.

Subsidiary Debtor's property right in the Hotel is a ninety-nine year leasehold, renewable forever. Subsidiary Debtor is the tenant, the Trustee is its landlord. What each certificate holder has is merely one or more of the 7000 equitable interests into which the *landlord's* equity has been divided. The *Subsidiary Debtor's* estate is merely a leasehold estate, and that has not been divided at all, and the certificate holder owns no part of that leasehold. What the certificate holder has is a right to his aliquot share of the income that remains to the landlord after the latter has paid the expenses.

This arrangement is a substitute for the business corporation method of group operation. How nearly parallel this trust runs to the corporation method may be noticed from the clauses in its Declaration of Trust (which corresponds to the Corporate Charter) in which absolute control and management is given to the Trustee (which corresponds to the Board of Directors) (R. 102, 639).

Article IX provides that:

"The Trustee may advise with legal counsel, and any action under this Trust Agreement taken or suffered in good faith by the Trustee in accordance with the opinion of such counsel shall be *conclusive on the Beneficiaries*, and the Trustee shall be fully protected in respect thereof. \* \* \*

"The Trustee shall have the *exclusive right to control* the Trust Estate as it may deem for the best interests of the Beneficiaries, *free from all control by the Beneficiaries*, as fully and to the same extent as though the Trustee were the sole legal and equitable owner thereof, and shall not be subject to any obligations to the Beneficiaries other than such as are expressly assumed hereunder." (Emphasis ours.)

Article V provides that:

"\* \* \* the Trustee shall have full authority \* \* \* in such case (termination of lease) or in any other contingency to take such other action with respect to the Lease or Trust Estate as it shall deem advisable, without reference to the Beneficiaries and as if it were the sole legal and equitable owner thereof, and *no person dealing with the Trustee shall be bound to inquire concerning the authority of the Trustee so to act.*" (Emphasis ours.)

Finally, there is a provision which is no doubt expressive of the rule which would prevail anyhow, to-wit (Article XIII) that:

"By the acceptance of any Certificate issued hereunder, the original or any successive holder shall be deemed to assent to all of the provisions contained in this Trust Agreement."

Thus the certificate holders have committed the management of the enterprise (the reversionary estate) as completely to the Trustee as though they had been incorporated. Had they used the corporate form instead of the trust form, no one would ever have expected that any holder of an interest in such corporation (that is, any stockholder)

would have filed any objection or application to intervene or any other pleading in a bankruptcy proceeding where their corporation's tenant was the bankrupt or debtor, or would have claimed that he was the holder of any lien (senior or otherwise) upon the leasehold estate. Such a pleading would have been thrown out immediately upon the ground that the Landlord corporation was the proper party, and that no stockholder of such corporation had any separate or individual right.\* This is precisely what happened in the case of *Commercial Cable Staffs' Association vs. Lehman, et al.* (1939, C. C. A., 2d) 107 F. 2d 917, where intervention was sought by an Association which was neither a creditor nor a stockholder of either debtor company but was only a creditor of a preferred shareholder. The Trial Court had permitted intervention; but the reviewing Court reversed this order and said:

"Since the association is neither a creditor nor a shareholder of either of the 'debtors,' it had no standing to object to the plan, unless it may speak for the Commercial Cable Company, as preferred shareholder of the 'Associated Companies.' It is impossible to find any basis for allowing it so to speak." (p. 920, 2d column.)

"The order of intervention was erroneous, and should not have been made; but it did not, and could not, create an interest in the reorganization which the Association did not have without it; it enabled the Association to appear, but it gave it no added standing to object to the plan." (p. 922.) (Emphasis ours.)

\* In such case had there been made a claim of fraud on the part of the corporation or its officers, intervention might have been allowed there, as here, to investigate such alleged fraud; but certainly it would go no further. If fraud were absent there as here, then the claim would be terminated there, as it should be here; and the claimant would certainly *not* be allowed to present himself as though he were a creditor or stockholder of the bankrupt tenant, nor to usurp the directors' function of speaking for the corporation on the question of the fairness and equity of its tenant's Plan of reorganization.

Similarly here petitioners are neither creditors nor shareholders of Subsidiary Debtor and they have no standing to object to the Plan, unless they may speak for The National City Bank of Cleveland, Trustee, and it is impossible to find any basis for allowing them so to speak. An order permitting them to intervene generally would have been erroneous. See also *In re South State Street Building Corporation* (C. C. A. Ill. 1943) 140 F. 2d 363, (certiorari denied, 322 U. S. 761).

The petitioners' argument might have been appropriate if the ownership in the Hotel property had been vested in a single corporation owning the fee simple title to the premises, with the petitioners as owners of a mortgage bond issue, and with Subsidiary Debtor (or its many former unsecured creditors, now its stockholders) as the stockholders in such corporation.

This is exactly what petitioners argued in the Trial Court—that the two situations just described were exactly equivalent; and the Court of Appeals, quoting the Trial Judge, rejected that argument succinctly when it stated in its opinion (R. 835):

“As stated by the district judge, this ‘is not a case of stockholder retention of interest to the detriment of bondholders and creditors’; but our concern is the problem of adjustment of the rights of lessor and lessee under a defaulted lease and the modification of a lease indenture.”

### C. The Adjustment of the Lease in the Reorganization.

The problem actually before the court, however, is that of a lease adjustment between the Subsidiary Debtor as tenant and the Trustee as its Landlord. As pointed out by the Special Master in his report recommending confirmation, this Landlord is a *single creditor*—the sole creditor in its class. There is no room or place for the usual process

and method of reorganization of creditors' rights by vote of  $\frac{2}{3}$ rds of a class of creditors.\*

Chapter X recognizes the lease problem [Sec. 106(7)]\*\* and makes special provision (Sec. 202)† for dealing with rejected leases. Sometimes, as here, a lease is not rejected but is modified by agreement made with the landlord. The United States Supreme Court dealt with such a problem in the reorganization case known as *Group of Institutional Investors, et al. vs. Chicago, Milwaukee, St. Paul and Pacific Railroad Company* (1943) 318 U. S. 523. The debtor was the tenant under a lease to it of a part of the railroad system known as the Terre Haute Division. The lessor Corporation's mortgage bondholders were permitted by the Court to be heard on their objections to the proposed

\* It is true that the Landlord in this case desired to amend its Declaration of Trust, as well as to compromise its back rent, and therefore had first to get consent to the amendment by the holders of  $\frac{3}{4}$ ths of the outstanding interests; but that process was beyond and outside the Chapter X reorganization and the jurisdiction of the Bankruptcy Court. As indicated by the Special Master's report (R. 37), the Court there departed from its bankruptcy functions and sat as a Court of Equity to investigate the alleged misconduct of the Trustee.

\*\* Sec. 106 contains definitions, and par. (7) states:

"‘Executory contracts’ shall include unexpired leases of real property.”

† Sec. 202 provides, in part:

“The claim of the landlord for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall be provable, but shall be limited to an amount not to exceed the rent, without acceleration, reserved by such lease for the three years next succeeding the date of the surrender of the premises to the landlord or the date of reentry of the landlord, whichever first occurs, whether before or after the filing of the petition, plus unpaid accrued rent, without acceleration, up to such date of surrender or reentry: *Provided*, That the court shall scrutinize the circumstances of an assignment of a future rent claim and the amount of the consideration paid for such assignment in determining the amount of damages allowed the assignee thereof.”

adjustment of the lease; but in answer to those objections the Court said at page 546:

*"Treatment of the Terre Haute Bonds.* The treatment accorded these bonds is attacked by the Terre Haute and representatives of its bondholders as well as by certain groups of Milwaukee bondholders. The Terre Haute interests contend, in the first place, that the plan contains no findings necessary for determining how the sacrifices required of these bondholders shall be distributed *inter se*. It is pointed out that the modifications proposed by the Commission for these four classes of bondholders are to be made regardless of the lien, security, interest or maturity of each and the earning power of the respective underlying properties. Hence it is argued that this phase of the plan is not fair and equitable, since it does not even attempt to preserve the respective priorities of these bond issues. The short answer to that objection is that the Terre Haute properties have not been treated by the Commission or the District Court as a part of the properties of the debtor for reorganization purposes. Nor has any question been raised or argued here as to the power of the Commission or the District Court so to treat them. The Commission and the District Court considered the problem solely as one of rejection or affirmation of a lease. The Terre Haute bondholders were in effect given the option to take the Terre Haute lines back or to agree to a reduced rental. If the Commission had authority to determine the question of rejection in the manner indicated and if it complied with the legal requirements for the exercise of that authority, the modifications which it proposed and which the District Court approved are valid. We think they are."

See also *In Re New York, New Haven & Hartford Railroad Co.* (C. C. A. Conn. 1945) 147 F. 2d 40, divisions 24, 25, 26 and 27 (certiorari denied in 325 U. S. 884), where the Court was dealing, not with a lease, but with a statutory corporate charter analogous to a lease. Parties interested in the charter attempted to object to the reorganization plan, but the Court said at p. 52:

"If the appellants are not to be regarded as creditors, as they contend, then they are merely offerees of a proposal for readjustment which they may accept or reject, and we cannot see that they were entitled to be heard."

Here, as there, the petitioners are not in any creditor-position, and have no standing to raise objections to the Plan; and here the Trustee for the certificate holders is in a position like that of the appellants in the cited case, of whom the Court said that they

"are merely offerees of a proposal which they may accept or reject."

The certificate holders have accepted the amendment to the Declaration of Trust by the requisite majority named in the amendment clause thereof, they have no right to invoke the absolute priority rule of *Case et al. vs. Los Angeles Lumber Products Co. Ltd.* (1939) 308 U. S. 106, they have no right to be heard here at all, and that should be the end of the matter.

As the Special Master said in his Report recommending confirmation (R. 46), which Report the Trial Judge accepted and approved (R. 83, 91):

"The acceptance of the Plan by the Bank does not involve the treatment of the debt only. Woven into the terms of the Plan, as they affect the debt, are the terms of adjustment and modification of the lease between the Bank and Subsidiary Debtor. The Bank evidently feels that the adjustments of the terms of the lease furnish a sufficient *quid pro quo*. That this feeling is not without justification is evidenced by the fact that from the evidence (Exhibits 'A' and 'D' attached to transcript of May 8, 1943), the Bank will receive, for the year beginning July 1, 1942, at least \$150,000.00 more than the sum of \$192,500.00 which it would receive under the terms of the 1927 lease." (R. 51.)

As it turned out, the Hotel income for the eighteen months period beginning July 1, 1942, was sufficient to have

paid the Trustee if the Plan had then been in effect,\* the sum of \$101,498.66 for the six months period beginning July 1, 1942, and the sum of \$451,893.93 for the next twelve months, or a total of \$553,392.59 for the eighteen months period, over and above the fixed minimum rental of \$262,500.00 for the eighteen months period (R. 675, 681, 683)—a total of \$815,892.59 as contrasted with the \$288,750.00 to which the Trustee would have been entitled for the same period under the old lease. This is an actual money consideration, and not a mere "imponderable."

#### D. Even under the Rule of Absolute Priority the Plan is Fair and Equitable.

The testimony on the subject of fairness and feasibility is found in the transcript of testimony of November 19, 1940, at R. 732 to 737 inclusive, in the transcript of testimony of June 12, 1943, at R. 706 to 709 inclusive, and in a stipulation dated May 10, 1944. (R. 674.) Exhibits are listed in the footnote.\*\*

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\* In determining these amounts, income taxes were estimated, and reorganization expenses were disregarded.

\*\* *Attached to the Plan*—

Exhibit A-4 (R. 707, 708, 715 to 717) gives the income account of the Cleveland Hotel for the years ended December 31, 1937, 1938 and 1939.

*Exhibits of November 19, 1940—*

Exhibit 2J shows how the Plan would have operated if in effect during the period from January 1, 1937, to December 31, 1940, when applied as stated in said exhibit (R. 732, 733, 739).

Exhibit 2-K is a projection for the years 1941 to 1960 inclusive, assuming for each year cash earnings equivalent to the average annual earnings on an accrual basis from January 1, 1937, to December 31, 1940, assuming the purchase of interests made at the full call price, and carrying qualifications as stated in said exhibit (R. 734, 735, 741).

Exhibit 2-L is a similar exhibit assuming purchase of interests at 65, with qualifications as expressed in said exhibit (R. 736, 737, 743).

(Continued on following page)

This section deals only with the fairness of the Plan. Petitioners do not question its feasibility.

As indicated in the foregoing sections, petitioners are essentially neither creditors nor lien holders, the Subsidiary

*(Continued from preceding page)*

Each of the exhibits relating to the testimony of November 19, 1940, was fully explained and discussed by the witness in the transcript of testimony of that date.

*Exhibits of June 12, 1943—*

Exhibit A, pages 1 and 2 (R. 707, 711, 713), is the income account of the Cleveland Hotel for the period beginning January 1, 1940, and ending April 30, 1943, thus bringing down to the latter date the information shown in Exhibit A-4 (R. 707, 708, 715 to 717).

Exhibit B (R. 707, 708, 719) sets forth Article V of the Reorganization Plan in the bankruptcy proceedings.

Exhibit C is the Plan. (R. 128-151.)

Exhibit D (R. 707, 708, 721, 722 and 723) shows the income account of the Hotel for the first five months of the year 1943, and thus brings said information down to the end of the last calendar month preceding the date (June 12, 1943) of said testimony.

*Exhibits Attached to the Stipulation—*

The stipulation filed May 10, 1944 (R. 674), brings the income account of the Hotel down to December 31, 1943. It also shows how the actual earnings of the Hotel for the period from July 1, 1942 (the effective date of the Plan, if confirmed), to December 31, 1943, will operate in payment of additional rents and retirement of certificates, if the Plan is confirmed, provided, however, that the figures are subject to certain qualifications relating to unknown items, such as reorganization costs and expenses, and taxes.

The exhibits to the stipulation are as follows:—

Stipulation Exhibit A—Income Account of Hotel for years ended December 31, 1940, 1941, 1942, and 1943 respectively (R. 677, 679).

Stipulation Exhibit B—Additional Rentals Earned and Retirements made if Plan had been in effect from June 30, 1942, to December 31, 1943, with interests purchased at then prevailing current market prices (R. 681).

Stipulation Exhibit C—Additional Rentals Earned and Retirements made if Plan had been in effect from June 30, 1942, to December 31, 1943, with interests purchased at the maximum redemption prices (R. 683).

Stipulation Exhibit D—Table of prevailing current market prices of interests from October, 1933 to March, 1944 (R. 685).

Debtor's property is not the fee, but is merely the leasehold estate, the petitioners have no interest in the leasehold estate, the problem is not one of stockholder retention of interest to the detriment of bondholders, and the question is merely one of lease adjustment.

However, even if the facts were as petitioners assume them to be, and even if the absolute priority rule of *Case et al. vs. Los Angeles Lumber Products Co. Ltd.* (1939) 308 U. S. 106 were applicable, the Plan is still fair and equitable. In that decision it was held that if the bondholders surrendered any prior rights, there must be an adequate consideration given in exchange. We shall show that this condition is amply satisfied by the present Plan.

The Plan was devised in the months prior to October 15, 1940. It was filed in the Trial Court on that date. The Hotel business was then still in the doldrums that followed the great depression. The Subsidiary Debtor was hopelessly insolvent. The leasehold and the hotel as a whole were never appraised. The used furniture and fixtures which were the security for the back rent had value as part of the equipment of a going business—otherwise they were mere junk. The Trustee was perfectly right when it wrote a certificate holder that:

"With respect to the large amount of accrued and unpaid rental, we believe that there is no possibility of substantial realization because aside from the security of the Hotel and its equipment (which will be retained as security under the Plan) there is an unsecured indebtedness of the Lessee Company of approximately \$60,000,000.00 with which the certificate holders' debt must participate in the very minor assets which are not subject to other burdensome liens." (R. 245.)

Moreover, neither the Trustee nor the holders of a large majority of interests desired to go into the hotel business. They evidently preferred to remain in the position of landlord-owners of a hotel property which is leased to

someone else for operation as a hotel. No prospective management was in sight (R. 83) that could and would give as good promise of successful operation as that of Subsidiary Debtor under the proposed lease.

Under these circumstances, Subsidiary Debtor was seeking the benefits of a law for the relief of debtors—the Bankruptcy Law. Yet the only relief it was able to obtain in respect of the Cleveland Hotel was almost negligible—so much so as to raise doubts of the propriety of Subsidiary Debtor's going forward with the Plan. This relief was three fold:

1. Exchange of the back rent claim for stock of the reorganized Subsidiary Debtor and a small amount of cash, both at the same ratio as that awarded to unsecured creditors. (The security for the back rent claim was obviously inadequate, and there would clearly be a large deficiency claim as to the Hotel, entirely unsecured.)

2. A reduction of fixed rent from \$192,500 per year to \$175,000 per year, but only from July 1, 1942, to December 31, 1955. This reduction thus amounted to \$17,500 per year for 13½ years only—a total reduction of \$236,500.00.

3. A provision permitting the purchase of certificates on behalf of the new corporation which is to be formed and owned by the Subsidiary Debtor, so as to permit said new corporation an opportunity eventually to earn the right to own the property.\*

In return for these slight concessions, the Subsidiary Debtor's said new corporation is required by the Plan:

1. To pay to the Trustee annually  $\frac{1}{2}$  of its net earnings (above fixed rent) to be divided into 7,000 equal shares (one for each of the 7,000 interests) to be disposed of as follows:

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\* This last feature is a major benefit to the certificate holders also, providing an assured market for those who wish to sell, and an improved security for those who do not, as indicated later in this brief.

- (a) In the case of each publicly held interest, its share shall be devoted to the payment of additional rent to the holder of such interest.
- (b) The remaining shares shall be devoted to the purchase of interests.

2. To pay to the Trustee annually, until 3,500 of the 7,000 interests shall have been purchased, the other  $\frac{1}{2}$  of such net earnings, the same to be used in the purchase of interests.

3. To meet certain minimum requirements for the amount of additional rent to be paid, and certain other minimum requirements for the amount to be paid for the purchase of interests.

4. To agree to pay liquidated damages of \$570,000.\* in case of default under the modified lease. (The present lease has no provision whatever for liquidated damages.)

5. To surrender its privilege of perpetual renewal of the lease, and its option to purchase a portion of the premises (retaining, however, its option to purchase the entire premises).

6. To pledge to the Trustee approximately \$139,000.00 (R. 50) of assets hitherto free from liens. All of these assets are pledged by the method of hypothecation of all the stock of the new Cleveland Hotel Corporation until  $\frac{1}{2}$  of the interests shall have been purchased; and in addition the tangible property is to be specifically pledged by a new or supplemental chattel mortgage.

7. To forego all dividends or profits until half of the interests shall have been purchased.

8. To issue to the Trustee about 1/65th of the stock of the reorganized The Cleveland Terminals Building Company plus a small amount of cash, in exchange for the back rent claim.

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\* This amount is three times the sum (\$190,000) of the initial fixed annual rent (\$175,000) and an item of underlying ground rent (\$15,000 per year), and is obviously based on the statutory maximum damages of three times the annual rent. Sec. 202. The Plan adopts this maximum and makes it "liquidated," i.e., contractual.

Every single one of these eight requirements is a substantial advantage to the Trustee (and through the Trustee, to the certificate holders) which it did not have under the old lease. These advantages more than compensate for the comparatively trifling concessions made by the Trustee. For example, the experience since July 1, 1942 (the effective date of the Plan, if the Order of Confirmation is affirmed) furnishes a complete answer to the objections concerning the back rent claim and the 13½ years ½% reduction of fixed rent. The record shows this experience down to December 31, 1943. In this 18 months' period, had the Plan actually been in effect, the additional rent would have amounted to \$272,553.60 (R. 675, 681) at the least—a sum greater than the entire 13½ years' reduction of fixed rent, which amounts to \$236,250.00, by \$36,303.60.\*

With the reduction of fixed rental thus amortized, the additional rental flowing from net earnings over the following years, when contrasted with the back rent claim, would soon surpass the latter, even taking into account the annual reduction in aggregate additional rent by reason of continuing annual purchases of interests.

This constitutes a real "money or money's worth" consideration, even under the rigid requirements of *Case vs. Los Angeles Lumber Products Co., Ltd., supra*. It cannot be shaken off as a mere imponderable.

Moreover the provision for retirement of interests was itself a great benefit to certificate holders. The great defect of the Land Trust Certificate as an investment has always been the lack of any provision for its eventual retirement. When the acceptance of this Plan was filed on June 29, 1942, and the fact became known that it contained a provision for purchase of interests, two things happened:

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\* In determining these amounts, income taxes were estimated, and reorganization expenses were disregarded.

1. The market price of interests began a steady advance upward from 55 (\$275.00 per \$500 interest) on that date to 89½ (\$447.50 per \$500 interest) on the last date (March, 1944) shown in the table (R. 676, 687, 688).

2. The objectors, the first of whom in importance had quietly been buying up interests since the Plan was mailed out on August 9, 1941 (R. 123, 639), joined Mr. Hott who on a date ten days (R. 12) after the acceptance was filed, had been only a "one man committee," reorganized him within three weeks into a six man committee (R. 70, 74, 75) and became very active in court in this proceeding in opposition to the Plan.

Obviously the advancing price of the interests that followed upon acceptance and the improved prospects of the Plan both evidenced the public's favorable opinion of the benefits of the Plan for certificate holders, and also terminated the cheap market in which some of the chief objectors had been quietly buying.

Examination of the experience of a single interest will make clear the monetary advantage which the Plan brings to the certificate holder. Under the old lease \$27.50 per interest per year was the fixed and invariable rent, and there was no "additional rent" whatever. Under the proposed lease\* a certificate holder would have had for each interest he owned, for the half year ended December 31, 1942, \$12.50 fixed rent plus \$7.25 additional rent, or a total of \$19.75 for the six months—a rate of \$39.50 on an annual basis. For the year 1943 he would have had for each interest \$25.00 fixed rent plus \$32.38 additional rent, or a total of \$57.88 on an annual basis—this as against \$27.50 per year under the old lease (R. 675, 681).

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\* In the following figures income taxes are estimated and reorganization expenses have been disregarded.

For subsequent years he would have had good prospects for further gratifying returns. On the other hand, he had a constantly improved market for the private sale of his certificate if he needed the principal for his personal wants—something the certificate holder had not theretofore had for about ten years. If his name were drawn by lot and his interest purchased by the Trustee contrary to his desire, it could only be by a return of his principal in full—another thing he could not have had at any time during the preceding ten years—plus a \$5.00 premium.

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Even if a liberal discount is allowed because these 18 months of experience came in war years (albeit early in the war) the results are still more than favorable to the certificate holder. Nevertheless Subsidiary Debtor made its bargain in good faith and would prefer to go through with it (in spite of its comparatively slight and actually temporary relief for possible difficult years until 1956, and with no relief at all for hard times if they come after December 31, 1955) and to complete its reorganization, than to reenter the field of negotiation and plan making once more.

From the certificate holder's point of view it should be noted that the effective date of the Plan, if the Order of Confirmation is affirmed, has already been fixed by its own terms (R. 130, 639) at July 1, 1942,\* so that the figures quoted above will represent actual disbursements to certificate holders, subject to determination of income tax,

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\* This provision for fixing the effective date of the Plan meets the test imposed by *Reconstruction Finance Corporation vs. Denver & Rio Grande Western Railroad Company* (June 10, 1946) . . . U. S. . . ., 66 S. C. 1282, as does the disposition of war time earnings through the provision for payment to the Trustee, for the benefit of certificate holders, of net earnings above fixed rental—all net earnings above fixed rental until one-half of the interests have been purchased, and thereafter one-half of such net earnings.

which has been estimated, and subject to reorganization expense, which has been disregarded.

No amount of theorizing can avoid the plain facts that have been revealed by this 18 months test. The Plan *does* carry substantial benefits for certificate holders, and those benefits *do* compensate for the acceptance of stock of the reorganized Subsidiary Debtor in exchange for back rent. The Special Master said in his Report on Confirmation:

"The Bank evidently feels that the adjustments of the terms of the lease furnish a sufficient *quid pro quo*." (R. 51.)

It is now evident that the bank was right.

As the Court of Appeals said in its opinion,

"\*\*\* it appears that the trustee exercised good business judgment in advocating acceptance of the plan of reorganization of the lessee-debtor." (R. 836.)

"As has been indicated, it is our judgment that, for the concession of its strict legal rights, the trustee under the plan of reorganization of the lessee-debtor receives a fair and equitable consideration for execution of the new lease for the benefit of the beneficiaries of the trust." (R. 839.)

The real grievance of petitioners seems to be that the Trustee did not insist upon a forfeiture of the leased premises and undertake to operate the Hotel itself, or turn it over to petitioners or their nominee, for operation. The Trustee, and a large majority of the certificate holders, did not think this course would be for the best interests of the certificate holders—even if such a forfeiture would have been permitted by the Bankruptcy Court, which, as a court of equity, abhors forfeitures. The Plan provided for a new lease which is demonstrably more favorable to the certificate holders than a continuance of the old lease, and at the same time gave the Lessee some inducement to continue the operation of the Hotel—first, for the benefit of the certificate holders and, second (and contingently)

for the benefit of the unsecured creditors of Subsidiary Debtor who have become the stockholders of the reorganized Subsidiary Debtor. In the judgment of the Special Master, the District Judge, and the Circuit Court of Appeals, as well as the Trustee and more than three-fourths of the certificate holders, the Plan was fair as well as feasible. Petitioners, as holders of a minority interest in the landlord's position, should not be allowed to upset the Plan, and so impose their will upon the overwhelming majority of the certificate holders, whose situation is similar to that of petitioners and who are not shown to have any ulterior interest or motive which would lead them to support a plan that did not serve the best interests of certificate holders as such.

#### **E. Conclusion.**

The petitioners are not properly before the Court on the question of Confirmation of the Plan. If, however, the contrary assumption is made as an hypothesis for the sake of argument, the problem is seen to be one of readjustment of the terms of a lease between Subsidiary Debtor and a single creditor, and not one of readjustment as between stockholders on the one hand, and bondholders with a prior lien, on the other hand. Even if it were the latter, a consideration which is more than adequate has been provided for what the Landlord surrenders, so that the Plan is fair and equitable within the test of all the authorities. Finally, the whole situation may be summed up thusly:

There is no other lease with a new lessee now available to be considered as an alternative to the proposed amended lease to a subsidiary of the present lessee. The dissenting certificate holders may say they could find such a lessee. If so, they should have brought him forward before this with a showing of his responsibility, and of the terms on which he would be

willing to make a lease. It seems beyond the realm of possibility that any responsible new lessee would be willing to make a lease under which the lessee was precluded from taking any cash profit out of the property unless and until one-half ( $\frac{1}{2}$ ) of the outstanding certificates had been paid off. We do not believe the Court will take seriously the assertion that such a lessee could be found, even if the Court were willing to go back of the discretion and authority which is granted by the Declaration of Trust to the Trustee to make decisions on such matters on behalf of the certificate holders. The choice is between

(1) A fair new lease to a lessee controlled and operated by personnel with a demonstrated capacity to operate a high-class hotel with a national reputation for high standards and good service, with a demonstrated capacity to operate at a large profit without departing from those standards, in a time when hotel business is good, and with a record of having failed to make profits, only when almost all other comparable hotel properties were also failing to make profits; and

(2) Demolishing the existing management structure and its appurtenant good will and "taking a chance" on the results of direct management by a bank trustee, or a possible new lease to a (yet undiscovered) new lessee, who would maintain the standards necessary to the long-term value of the property and its appurtenant business, for a reward as small, and as long postponed, as that provided for the proposed subsidiary lessee and its owners under the Hotel Plan now before the Court.

The Trustee wisely decided in favor of the first alternative, and holders of more than three-fourths ( $\frac{3}{4}$ ths) of the outstanding interests have ratified that decision. The dissenting certificate holders should not be allowed to upset this decision and force the Trustee and the majority cer-

tificate holders into a speculation they do not want, and do not consider a sound business policy.

Respectfully submitted,

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*Attorneys for Subsidiary Debtor.*

HAUXHURST, INGLIS, SHARP & CULL,

*Of Counsel.*

**FILE COPY**

SEP 18 1946

**In the Supreme Court of the United States**

OCTOBER TERM, 1946.

**No. 448.**

IN THE MATTER OF  
VAN SWERINGEN CORPORATION,

*Debtor,*

and

THE CLEVELAND TERMINALS BUILDING COMPANY,  
*Subsidiary Debtor.*

THE CLEVELAND HOTEL PROTECTIVE COMMITTEE,

J. C. LINCOLN, GORDON MACKLIN, ROBERT H. JAMISON,

MELVIN B. HOTT AND ROY BRENHOLTS,

Individually and as Members of said Committee,

and

THE HENRY GEORGE SCHOOL OF SOCIAL SCIENCE,  
Intervening Petitioners,

*Petitioners,*

vs.

THE NATIONAL CITY BANK OF CLEVELAND,

Successor Trustee,

and

THE CLEVELAND TERMINALS BUILDING COMPANY,

*Respondents.*

IN PROCEEDINGS FOR THE REORGANIZATION  
OF A CORPORATION.

ON PETITION FOR WRIT OF CERTIORARI,  
TO THE UNITED STATES CIRCUIT COURT OF APPEALS,  
FOR THE SIXTH CIRCUIT.

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BRIEF FOR RESPONDENT,  
THE NATIONAL CITY BANK OF CLEVELAND,  
SUCCESSOR TRUSTEE,  
OPPOSING PETITION FOR WRIT OF CERTIORARI.

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(Names of Counsel on inside of Cover.)

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*Successor Trustee.*

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In the Supreme Court of the United States

OCTOBER TERM, 1946.

No. 448.

IN THE MATTER OF  
VAN SWERINGEN CORPORATION,

*Debtor,*

and

THE CLEVELAND TERMINALS BUILDING COMPANY,  
*Subsidiary Debtor.*

THE CLEVELAND HOTEL PROTECTIVE COMMITTEE,  
J. C. LINCOLN, GORDON MACKLIN, ROBERT H. JAMISON,  
MELVIN B. HOTT AND ROY BRENFOLTS,  
Individually and as Members of said Committee,  
and

THE HENRY GEORGE SCHOOL OF SOCIAL SCIENCE,  
Intervening Petitioners,  
*Petitioners,*

vs.

THE NATIONAL CITY BANK OF CLEVELAND,  
Successor Trustee,  
and

THE CLEVELAND TERMINALS BUILDING COMPANY,  
*Respondents.*

IN PROCEEDINGS FOR THE REORGANIZATION  
OF A CORPORATION.

ON PETITION FOR WRIT OF CERTIORARI,  
TO THE UNITED STATES CIRCUIT COURT OF APPEALS,  
FOR THE SIXTH CIRCUIT.

BRIEF FOR RESPONDENT,  
THE NATIONAL CITY BANK OF CLEVELAND,  
SUCCESSOR TRUSTEE,  
OPPOSING PETITION FOR WRIT OF CERTIORARI.

**STATEMENT OF THE CASE.****The Proceedings.**

The petition for writ of certiorari filed herein is filed under Section 240 of the Judicial Code (28 U. S. C. 347 (a)).

It seeks a review of the judgment entered on May 31, 1946, by the United States Circuit Court of Appeals for the Sixth Circuit, which judgment affirmed the order of the District Court of the United States for the Northern District of Ohio which found that the so-called Cleveland Hotel Plan was fair and equitable and feasible, and confirmed said Plan, and ordered it to be consummated as of July 1, 1942.

The Cleveland Hotel Plan was proposed in the proceedings for reorganization, under Section 77B and Chapter X of the Federal Bankruptcy Act, of Van Sweringen Corporation, debtor, and The Cleveland Terminals Building Company, subsidiary debtor, which proceedings were begun by appropriate petitions of the debtor and the subsidiary debtor filed in the District Court in October, 1936. The Cleveland Hotel Plan was subject to the provisions of the subsidiary debtor's General Plan of Reorganization, so far as relevant. As to the assets and liabilities of the subsidiary debtor unconnected with the Cleveland Hotel (and they were many) said General Plan has already been consummated.

**The General Situation Involved.**

The Cleveland Terminals Building Company (hereinafter sometimes referred to as the "Building Company") holds, as lessee, a ninety-nine year renewable lease on the Cleveland Hotel. The lessor under this lease is now The National City Bank of Cleveland, as successor trustee under an Agreement and Declaration of Trust, dated April 1, 1927. The Guardian Trust Company was the original trustee under said Declaration of Trust.<sup>1</sup> The National City Bank

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<sup>1</sup> See Agreement and Declaration of Trust, April 1, 1927 (R. 102).

of Cleveland succeeded to the trusteeship in March, 1935, after the failure of The Guardian Trust Company (R. 550). Said successor trustee is hereinafter sometimes referred to as the "Trustee."

In April, 1927, The Guardian Trust Company, having acquired a title to the Cleveland Hotel property, executed an Agreement and Declaration of Trust, dated April 1, 1927 (R. 102), declaring itself trustee of said property for the holders of so-called fee ownership certificates to be issued under said Declaration of Trust. The Declaration of Trust divided the trust estate into seven thousand indivisible equal interests, and the fee ownership certificates issued under the Declaration of Trust each represent one or more of those equal interests. These interests were originally sold to the public at about \$500.00 per interest.

The Guardian Trust Company, as trustee as aforesaid, and as owner of the Cleveland Hotel property, leased said Cleveland Hotel property to The Cleveland Terminals Building Company under a ninety-nine year lease, renewable forever, likewise dated April 1, 1927.<sup>2</sup> Under the 1927 lease the Building Company was required to pay a fixed rent of \$192,500.00 per year, payable in quarterly installments of \$48,125.00 each. This rent (hereinafter referred to as the "fixed rent") amounted to \$27.50 per year on each one seven thousandths interest in the Cleveland Hotel property (or 5½% on the original sale price of each such interest).

In 1932 the fixed rent obligations of the 1927 lease were modified by two Supplements to and Modifications of Lease (Physical I. P. Exhibits 3B and 3C; and R. 724) so as to postpone until July 1, 1942, the due date of the fixed rent for the period from April 1, 1932, to June 30, 1937, but also so as to require the Building Company to pay to the trustee-lessor in cash monthly, against said fixed rent, all of the

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<sup>2</sup> See Indenture of Lease, April 1, 1927 (Physical I. P. Exhibit 3).

net earnings of the leased premises available in cash until the amount of the fixed rent so postponed had been paid in full with interest at the rate of 5½% per annum. The 1932 modifications also required the Building Company to execute and deliver to the trustee-lessor an equipment lease and a chattel mortgage on all of the Cleveland Hotel furniture and equipment, each in effect securing the payment of the postponed rent. The equipment lease and the chattel mortgage so required were duly executed by the Building Company. Other requirements of the 1927 lease were not affected by the 1932 modifications.

In October, 1936, the Building Company filed its petition for reorganization in these proceedings. Thereupon, the Trustee filed with the Special Master in the reorganization proceedings its proof of claim against the Building Company for rent and other unpaid obligations accrued to October 13, 1936, with interest thereon to that date (R. 94). This claim was subsequently allowed as of October 13, 1936, for an aggregate amount of \$897,562.59, and was classified, in its own class, as secured by the instruments of lease and chattel mortgage above-mentioned (R. 100). The value of said security was not then determined, but, subsequently, in October, 1943, the Special Master determined the value of said security at that time to be \$508,473.98 (R. 49).

#### The Parties Here.

The petitioners are the owners and the representatives of owners of a small minority of interests evidenced by certain of the so-called fee ownership certificates issued under the Declaration of Trust, dated April 1, 1927.<sup>3</sup> The respondents are the Trustee and the Building Company, the subsidiary debtor.

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<sup>3</sup> The representation of the petitioners is 692 interests at the outside. Of these, not more than 188 interests were acquired by the petitioners, and those represented by them, prior to the reorganization proceedings. This is about 2.7% of the 7,000 interests outstanding.

### The Cleveland Hotel Plan.

The statement of the "substance" of the Cleveland Hotel Plan in Petitioners' Brief, pages 11-12, is incomplete in many respects and inaccurate in others.

Disregarding provisions thereof which do not appear to be involved here, the Cleveland Hotel Plan (R. 128-151) proposes generally as follows:

1. A new corporation shall be organized, to which will be transferred, free and clear of all claims and liens except those of the Trustee, the Building Company's lease and leasehold of the Cleveland Hotel and all property of every kind and description incident to or growing out of the operation of the Cleveland Hotel (R. 129). This includes the property covered by the aforementioned equipment lease and chattel mortgage, and also property which has been found to be free and unpledged and to have a value in the amount of \$138,908.57 (R. 49-50).

2. The Cleveland Hotel lease shall be modified as follows:

(a) The fixed quarterly rent (to be distributed to certificate holders) shall equal  $1\frac{1}{4}\%$  of the product arrived at by multiplying \$500.00 by the number of publicly held interests at the time of the particular payment (R. 136). This amounts to \$175,000.00 per year so long as the 7,000 publicly held interests now outstanding remain outstanding. Publicly held interests are those which shall not have been purchased by the Trustee under (c) below (R. 143).

(b) There shall also be paid, annually, as additional rent (to be distributed to certificate holders) a sum equal to the amount arrived at by multiplying one-half of the net earnings (as defined in the Plan) of the Cleveland Hotel by the number of publicly held interests and dividing that result by 7,000; provided that if such amount is less than  $\frac{1}{2}\%$  of the product arrived at by multiplying \$500.00 by the number of publicly held interests, the sum to be paid shall be increased to said  $\frac{1}{2}\%$ , to the extent that one-half of said

net earnings will permit; and provided, further, that commencing in 1957 the sum to be paid shall never be less than said  $\frac{1}{2}\%$  (R. 137).

(c) The balance of the net earnings of the Cleveland Hotel shall be paid, annually, to the Trustee, not as rent but to be used by the Trustee for the purchase of publicly held interests either on proffer from such holders as may be willing to sell the same at less than \$505.00 per interest, or by lot at \$505.00 per interest (R. 138); provided that when the number of publicly held interests has been reduced from 7,000 to 3,500 or less, the sum required to be so paid to the Trustee shall be reduced by a sum equal to one-half of the net earnings of the Cleveland Hotel (R. 139). Beginning with the year 1946, however, the sum required to be so paid to the Trustee shall be not less than certain minima set forth in the Plan (R. 140).

(d) The aforesaid payments of fixed rent, together with the aforesaid payments on account of net earnings, shall never be less than \$175,000.00 in respect of any calendar year (R. 140).

(e) "Net earnings" are particularly defined, and management compensation deductible in arriving at net earnings is strictly limited (R. 142).

(f) Provisions with respect to the payment of underlying ground rent (\$15,000.00 per year) and expenses, including the compensation of the Trustee, shall correspond to the provisions of the existing lease (R. 136, 138). But the provisions of the existing lease for payments into a depreciation fund shall be eliminated (R. 144).

(g) In the event that the lease, as modified by the Plan, is terminated on account of default of the lessee, the liquidated damages of the Trustee as lessor shall be fixed at \$570,000.00 (R. 144).

(h) To further secure the performance by the lessee of each and every covenant and agreement of the lessee in the lease, as modified by the Plan, and to secure the payment of the liquidated damages aforementioned, (1) the lessee shall give to the Trustee a chattel mortgage on all of the furniture, furnishings,

equipment and trade and tenant fixtures of the Cleveland Hotel, and shall keep the same insured up to 90% of the full insurable value thereof, and (2) until the publicly held interests have been reduced from 7,000 to 3,500, the lessee shall also pledge or cause to be pledged with the Trustee all of the lessee's (the new corporation's) capital stock and all dividends and distributions thereon (R. 144-146).

3. The new corporation shall assume all debts and obligations arising out of the operation of the Cleveland Hotel, and shall also assume all the obligations of the Cleveland Hotel lease, as modified by the Plan, except the accrued and unpaid rent (as defined in the Plan) as of the day the Plan is consummated (R. 129). This accrued and unpaid rent amounts to \$1,109,904.31 as of July 1, 1942 (R. 89).

4. As to the claim of the Trustee for accrued and unpaid rent, the Trustee shall receive the same relative distribution as general creditors of the Building Company receive on their allowed claims (R. 150). This consists of a cash distribution and one-tenth of a share of stock of the reorganized Building Company for each \$81.44 of allowed claim. (See Article VII of the Building Company's General Plan of Reorganization referred to, *infra*.)

5. The Building Company (the subsidiary debtor) shall be released from all obligations under the Cleveland Hotel lease (R. 130).

The Cleveland Hotel Plan is subject to the provisions, so far as relevant, of the Building Company's General Plan of Reorganization,<sup>4</sup> and in said General Plan of Reorganization, it is provided in Article VIII, Section VIII, sub-

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<sup>4</sup> See Amended Plan of Reorganization, being changes and modifications dated October 1, 1940, of Plan of Reorganization of Van Sweringen Corporation and The Cleveland Terminals Building Company dated May 18, 1937, as heretofore amended, insofar as the same deals with the assets and liabilities of The Cleveland Terminals Building Company, and with certain assets and liabilities of Van Sweringen Corporation (an unnumbered Physical Exhibit, being a printed booklet of 98 pages).

section 5, that in the event of the failure of any class of secured claimants to accept the Plan, then (unnumbered physical exhibit, page 46)

"In case the holder or holders of any such secured claim shall also sustain the relation of landlord to The Cleveland Terminals Building Company, then The Cleveland Terminals Building Company may, under appropriate orders of the Court, reject the lease involved in such relation \* \* \*."

The Cleveland Hotel Plan provided (R. 130) that it should become effective when the Trustee determined that three-fourths in interest of the certificate holders had consented to and approved the Plan; and the Trustee did not accept the Plan until it had the required consents and approvals of the certificate holders.<sup>5</sup> The Trustee accepted the Plan on June 29, 1942.

The certificate holders' consents to and approvals of the Cleveland Hotel Plan were given as beneficiaries under the Declaration of Trust, dated April 1, 1927, and not as creditors of the Building Company. (The Declaration of Trust provides that it may be amended by the consent of the Trustee and three-fourths in interest of the certificate holders.) The Trustee was a creditor of the Building Company, but the certificate holders were not creditors of that company.

#### **The Declaration of Trust.**

In the Declaration of Trust, dated April 1, 1927 (I. P. Exhibit 2; R. 102), under which the Trustee is acting, it is provided that (Article V; R. 116):

"In the event that the Lessee shall make default in any of the provisions of the Lease \* \* \* then the Trustee

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<sup>5</sup> In the courts below the petitioners contended that the Trustee did not have the required consents and approvals of the certificate holders. The courts below decided this issue against the petitioners and it is not involved here. (See Petitioners' Brief, page 7.)

shall have full authority to terminate the Lease . . . , and in such case or in any other contingency to take such other action with respect to the Lease or Trust Estate as it shall deem advisable, without reference to the Beneficiaries and as if it were the sole legal and equitable owner thereof . . ." (Italics ours.)

#### **Other Facts.**

A few other detailed facts will be stated in the argument, *infra*, insofar as they seem relevant to the discussion there.

#### **ARGUMENT.**

##### **The Opinion Below.**

The opinion of the Circuit Court of Appeals is reported in 155 F. (2d) 1009, and is found in the Record at pages 829 to 839. It meets every argument of the petitioners here, and, we submit, is completely sound in its conclusions.

##### **The Cleveland Hotel Plan.**

###### **1.**

The Cleveland Hotel Plan gives to the Trustee the alternative of taking a rejection of its existing lease with all the consequences incident to such rejection, or of accepting a modified lease on the terms proposed in the Plan. Since, under the Plan, the Trustee could have its strict legal rights, as upon rejection, if it wanted them, the Plan conforms to the principles of the Milwaukee case, and is not in conflict with the principles of the Los Angeles case.

The petitioners bottom their argument in their attack upon the Cleveland Hotel Plan on *Case v. Los Angeles Lumber Products Company, Ltd.*, 308 U. S. 106; 84 L. ed. 110. In the *Los Angeles* case the debtor company had assets valued at about \$850,000, and a mortgage debt of some \$3,800,000. The plan of reorganization provided that the

assets would be transferred to a new company, the mortgage cancelled and the bondholders given, in place of their bonds, 5% non-cumulative preferred stock, while the so-called Class A stockholders of the old insolvent company would receive all of the common stock of the new company without the payment of any assessment or subscription. In holding the plan unfair, this court reiterated the principle that "to the extent of their debts, creditors are entitled to priority over stockholders against all the property of an insolvent corporation"; and the court found that the stockholders were furnishing no sufficient consideration for their stock in the reorganized company.

The *Los Angeles* case is clearly different from the case at bar. It involved an adjustment of the relations between creditors and shareholders of an insolvent corporation. The present case, as the courts below agreed, "is not a case of stockholder retention of interest, to the detriment of bondholders" (R. 82; 835). Here, we are concerned with an adjustment of the rights of a lessor and a lessee, and the modification of an existing lease. This distinction was recognized by this court in *Group of Institutional Investors v. Chicago, M. St. P. & P. R. Co.*, 318 U. S. 523; 87 L. ed. 959. That case involved the plan of reorganization of the Chicago, Milwaukee, St. Paul & Pacific Railroad Company, and one of the issues concerned that company's lease of the properties of the Chicago, Terre Haute & South-eastern R. Co. The Terre Haute had outstanding four bond issues secured by liens on lines and trackage rights in Indiana and Illinois and carrying 4% and 5% interest. The Milwaukee operated the lines of the Terre Haute under a lease, by which the Milwaukee agreed to pay the Terre Haute's expenses, and to meet the interest and principal obligations on the Terre Haute bonds as they became due. The Milwaukee met all interest payments, but it defaulted in the payment of the principal obligations on one of the Terre Haute bond issues and failed to maintain the equipment to

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full extent of its undertaking. The Milwaukee plan of reorganization provided (see 318 U. S. 532-534) for the execution of a new lease between the Terre Haute and the reorganized Milwaukee on condition that substantially all Terre Haute bondholders agree to an extension of the maturity of their bonds and a reduction in the fixed interest charges, and waive the equipment failures. Under the new lease, the lessee would assume the payment of the principal of, and the interest on, the modified bonds and also the corporate expenses of the Terre Haute. This plan was rejected by certain Terre Haute bondholders as unfair and inequitable (citing the *Los Angeles* case), on the ground that the modifications proposed for the four classes of Terre Haute bondholders were to be made "regardless of the lien, security, interest or maturity of each and the earning power of the respective underlying properties." (See 318 U. S. 546.) This court denied the contention of the Terre Haute bondholders, and said, 318 U. S. 546-547):

"\* \* \* The short answer to that objection is that the Terre Haute properties have not been treated by the Commission or the District Court as a part of the properties of the debtor for reorganization purposes. Nor has any question been raised or argued here as to the power of the Commission or the District Court so to treat them. The Commission and the District Court considered the problem solely as one of rejection or affirmance of a lease. The Terre Haute bondholders were in effect given the option to take the Terre Haute lines back or to agree to a reduced rental. If the Commission had authority to determine the question of rejection in the manner indicated and if it complied with the legal requirements for the exercise of that authority, the modifications which it proposed and which the District Court approved are valid. We think they are."

In other words, the court held that since the lessor was given the option of accepting a rejection of the Terre Haute lease and taking back the leased properties, the lease

modifications proposed by the lessee in the alternative were valid even though they disregarded the priorities then existing between the several classes of bondholders of the lessor.

A similar issue was involved and decided in like manner by the Circuit Court of Appeals for the Second Circuit in *In re New York, New Haven & Hartford R. Co.*, 147 F. (2d) 40, 51 (certiorari denied, 325 U. S. 884; rehearing denied, 325 U. S. [No. 2] xviii). The court in that case considered the objections of bondholders of the Boston Terminal Company to the plan of reorganization of the New Haven railroad. The Terminal Company was a Massachusetts corporation created by a special act of the Massachusetts legislature, which act required the New Haven railroad, among others, to use the terminal of the Terminal Company and to pay the Terminal Company for such use a percentage of the charges and expenses of the Terminal Company, including the interest on its outstanding bonds. The bondholders of the Terminal Company objected to that part of the plan of reorganization of the New Haven railroad which purported to relieve the New Haven railroad from the statutory obligation to use the terminal of the Terminal Company and which reduced, retroactively to 1939, the compensation to be paid for such use since 1939 and in the future. In affirming the action of the District Court dismissing the objections of bondholders of the Terminal Company, and approving the plan in the respect in question, the Circuit Court of Appeals said (pages 51-52):

"• • • The provisions were correctly construed by the district judge to constitute an offer of a revised arrangement which the Terminal Company is free to accept or reject after submission of the offer to it. If it accepts, it waives any claim for greater compensation; if it rejects, it may claim as an administrative expense compensation for use of the property by the reorganization trustees during these proceed-

ings and may file a claim for any damages to which it may be entitled by reason of abrogation of the statutory obligations for the future.

" \* \* \* The plan enables New Haven to reject what in effect amounts to a burdensome lease. The plan, however, does not compel Boston Terminal to furnish the service at the rental offered; if Boston Terminal does not choose to accept the offer, it can, as a creditor, file proof of claim against New Haven for any damages to which it may be entitled. \* \* \* .

" \* \* \* Hence the amount of the offer is a matter of business judgment to be considered from the standpoint of New Haven's interests rather than a statutory requirement that assets of a debtor to be organized in these proceedings be valued by the Commission. See *Group of Institutional Investors v. Chicago, M., St. P. & P. R. Co.*, 318 U. S. at page 550, 63 S. Ct. at page 742, 87 L. Ed. 959."

Similarly, the Cleveland Hotel Plan is an alternative to rejection of the Cleveland Hotel lease by the Building Company. The alternative of rejection of the hotel lease is provided for in Article VIII, Section VIII, subsection 5, of the General Plan of Reorganization of the Building Company, which stipulates that in the event of the failure of any class of secured claimants to accept the Plan, then (unnumbered physical exhibit, page 46)

"In case the holder or holders of any such secured claim shall also sustain the relation of landlord to The Cleveland Terminals Building Company, then The Cleveland Terminals Building Company may, under appropriate orders of the Court, reject the lease involved in such relation \* \* \*."

As pointed out in the *Milwaukee* case, the Cleveland Hotel Plan is not subject to the same rules as a plan which deals with the adjustment of relations between creditors and shareholders of an insolvent company. The Cleveland Hotel Plan gives to the Trustee the alternative of taking a rejection of its existing lease with all the consequences inci-

dent to such rejection, or of accepting a modified lease on the terms proposed in the Plan.<sup>1</sup> Under the *Milwaukee* and *New Haven* cases such alternative is free from attack, because the Trustee can have its strict legal rights, as upon rejection, if it wants them.

## 2.

The Cleveland Hotel Plan is fair and equitable, however, even under the principles of the Los Angeles case, since under the Plan the Trustee receives, through a new lease, a fair and equitable consideration for waiving its security for part of its back rent claim.

In approaching that proposition, it is desirable, in order that the court may follow easily the argument herein-after made, to restate a few facts which have already been stated, *supra*.

The underlying title of the Cleveland Hotel is owned by The National City Bank of Cleveland, Trustee. It holds the underlying title for the use and benefit of the holders of certain so-called fee ownership certificates, which represent, in the aggregate, 7,000 interests. The underlying title of the Cleveland Hotel is subject to an indenture of lease, dated April 1, 1927, as subsequently modified, under which the Building Company, the subsidiary debtor, is lessee.

The Building Company is in default for back rent under said lease to the extent of approximately \$1,100,000.00; and the Trustee has a claim against the Building Company for said back rent. This claim of the Trustee is secured by a chattel mortgage on certain furniture and equipment of the Building Company, valued at approximately \$500,000.00. Realistically, therefore, about \$600,-

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<sup>1</sup> The choice of the alternatives lies with the Trustee. It does not lie with the Building Company, the subsidiary debtor, which is the inference left by the first full paragraph on page 19 of Petitioners' Brief.

000.00 of the back rent claim of the Trustee is unsecured, and is entitled to no different treatment than the claims of other general creditors of the Building Company. Under the Cleveland Hotel Plan, however, the entire back rent claim of the Trustee is accorded the same treatment as unsecured claims against the Building Company generally.

The basic objection of the petitioners to the Cleveland Hotel Plan is based on this treatment of the Trustee's back rent claim. They argue that, by reason of this treatment, the Plan releases to the lessee the security now pledged to the Trustee, as lessor, against its back rent claim, and that, consequently, the Plan violates the principles of the *Los Angeles* case. The petitioners have variously phrased this alleged defect, but finally all of their objections come back to this one.

So far as we can find, there is nothing in the *Los Angeles* case or the other decisions of this court following it that requires that a reorganization plan sequester to each secured creditor the exact security held by such creditor. All that the authorities hold is that if a secured creditor's security is released to the debtor in a reorganization plan, then the secured creditor must be given in that plan a fair *quid pro quo* for the security so released. (See *Consolidated Rock Products Co. v. Du Bois*, 312 U. S. 510, 530; 85 L. ed. 982, 996.) In the last analysis, therefore, even if the principles of the *Los Angeles* case are applicable, the issue turns upon a judgment as to whether or not the Trustee, under the Cleveland Hotel Plan, receives a fair and equitable consideration for waiving its security on approximately \$500,000.00 of its back rent claim. The Circuit Court of Appeals, the District Judge and the Special Master each found that the Trustee is receiving a fair and equitable consideration. We submit that it is. In any event said findings in that regard are conclusive here unless clearly erroneous.

Under the Cleveland Hotel Plan, for waiving its security on its back rent claim, the Trustee receives

1. A claim as an unsecured creditor for both the secured and unsecured portions of its back rent claim; and
2. A new, and, as the Trustee believes, very favorable lease on the Cleveland Hotel property, from a company which will put behind the new lease assets of more than \$125,000.00, in or against which the Trustee now has no right or claim.

If the new lease which the Trustee will receive under the Cleveland Hotel Plan is a very favorable lease to the Trustee, then it seems perfectly clear that the Trustee is receiving a fair *quid pro quo* for waiving its security on its back rent claim, and that the Plan is good. We submit that the Trustee is receiving under the Plan not only a very favorable lease, but a lease far more favorable to it than it could otherwise hope to make on the Cleveland Hotel property.

It is not hard to demonstrate that this is so. Under the proposed new lease, the lessee thereunder agrees

1. To pay a fixed net rent at the rate of \$25.00 per year for each interest outstanding at the time (\$175,000.00 per year so long as the 7,000 interests now outstanding remain outstanding);
2. To pay annually additional rent at the rate of 1/7000th of one-half of the net earnings of the Cleveland Hotel for each interest at the time outstanding (each interest thus to receive by way of additional rent its ratable share of one-half of the hotel's net earnings); provided, however, that if the additional rent for any year calculated as aforesaid does not equal \$2.50 per interest, then one-half of the net earnings of the Cleveland Hotel will be paid as additional rent in so far as it is required to provide additional rent of \$2.50 per outstanding interest;<sup>2</sup> and, provided further, that commencing with the year 1956 this additional rent must always equal \$2.50 per interest per year; and

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<sup>2</sup> This provision becomes increasingly valuable as interests are retired.

3. To apply the entire balance of the net earnings of the Cleveland Hotel to the purchase or call of the outstanding interests until one-half of the presently outstanding 7,000 interests are retired. (Under the existing lease the lessee is not required to purchase any interests.)

The proposed new lease, under the Cleveland Hotel Plan, will contain an entirely new liquidated damage clause in the amount of \$570,000.00,<sup>3</sup> and will be secured by a pledge of all of the Cleveland Hotel furniture and equipment, thus enabling the Trustee, without cash outlay, to take over the furniture and equipment if the lease ever goes into default. The proposed new lease will also be secured, until one-half of the presently outstanding interests are retired, by a pledge of all of the lessee's capital stock. For the further protection of the Trustee and the certificate holders, the lessee agrees, in the proposed new lease, that, until one-half of the presently outstanding interests are retired, it will not, without the consent of the Trustee, assign or mortgage the lease or sub-let the leased premises or engage in any business other than the operation of the Cleveland Hotel, and that all executive salaries and compensation for management in operating the hotel, howsoever paid, will not exceed in the aggregate 2% of the gross cash receipts of the hotel (R. 142).

From the foregoing, three things are perfectly manifest:

*First:* In addition to the fixed rent (\$175,000.00 per year so long as the 7,000 interests now outstanding remain outstanding), the Trustee (and through it

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<sup>3</sup> The amount of \$570,000.00 is three years of the minimum annual payments required to be made by the lessee under the proposed lease on account of fixed rent and in respect of net earnings (\$175,000.00 per year; R. 140), plus three years of underlying ground rent required to be paid by the lessee under the proposed lease (\$15,000.00 per year; R. 136-137). See 11 U. S. C. 602. The liquidated damages provision in the proposed lease is perfectly good. See *Jones v. Stevens*, 112 O. S. 43.

the certificate holders) will receive an equitable participation in one-half of the net earnings of the Cleveland Hotel.

*Second:* All net earnings of the Cleveland Hotel not paid to the Trustee as additional rent will be devoted to the purchase or call and retirement of outstanding interests until one-half of the now outstanding interests have been retired (and the intrinsic worth of the then remaining outstanding interests doubled).

*Third:* Neither the lessee nor the Building Company (as the lessee's sole stockholder) can take one dollar out of the Cleveland Hotel or its operations until one-half of the now outstanding interests have been retired.

It is submitted that it is completely clear that no other prospective lessee of the Cleveland Hotel would be willing to make a lease on terms as favorable to the Trustee as are proposed in the Cleveland Hotel Plan. By an unlimited participation in one-half of the net earnings of the Cleveland Hotel, the Trustee (and through it the certificate holders) are given an equitable participation in the expected prosperity of the Cleveland Hotel. The lessee cannot take one dollar out of the Cleveland Hotel or its operations until one-half of the now outstanding interests are retired; and until that event occurs, every dollar earned by the Cleveland Hotel and not applied to rent must be devoted to building up the intrinsic worth of the interests not retired. A new face, looking for a lease on the Cleveland Hotel, certainly would not be willing to give all of these advantages to the Trustee,<sup>4</sup> for they mean not only that the Trustee (and through it the certificate holders) share equitably in the prosperity of the Cleveland Hotel, but also that the lessee cannot hope to realize anything out of the Cleveland Hotel and its operations except and unless

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<sup>4</sup> Compare, for example, the suggestions which a representative of the Allerton Hotels made to Mr. Hott, one of the petitioners (R. 570).

it provides a long successful operation of the hotel. If in the meantime the lease goes into default, the Trustee (and through it the certificate holders) get back the hotel and all of its furniture, equipment, inventory and other incidental property, lock, stock and barrel (including the assets which the Special Master found to be free and unpledged under the existing chattel mortgages), and have had the benefit of all of its earnings until then.

Actual experience since July 1, 1942, has demonstrated how valuable the lease provided for in the Cleveland Hotel Plan is to the Trustee and the certificate holders. The net earnings of the Cleveland Hotel for the last six months of 1942 were approximately \$101,500.00 (R. 681);<sup>5</sup> for the year 1943 they were approximately \$451,900.00 (R. 681); or a total for the eighteen months of approximately \$553,400.00.<sup>6</sup> Of this amount approximately one-half, or \$276,700.00, would go under the proposed lease to the Trustee (for the benefit of certificate holders) as additional rent. For the eighteen months, therefore, the Trustee would receive as rent for the certificate holders said sum of approximately \$276,700.00 plus the fixed rent of \$262,500.00 (\$175,000.00 x 1.5), or a total of approximately \$539,200.00, which on an annual basis would be approximately \$359,400.00 (two-thirds of \$539,200.00). This amount of rent of approximately \$359,400.00 compares with the annual rent of \$192,500.00 stipulated in the existing lease. But this is not the whole story. The lessee could not take down one dollar of the hotel net earnings for itself or the Building

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<sup>5</sup> The figures used in this paragraph disregard reorganization expenses which are not presently known, and possible adjustment of income tax reserves.

Also, for simplicity, we have not adjusted the additional rent figures given in this paragraph to reflect any retirement of interests at the end of 1942 out of 1942 earnings.

<sup>6</sup> It should be stated that the record in this case before the District Court was completed over two years ago, so that figures for 1944 and 1945 are not in the printed record.

Company, its stockholder. Under the proposed lease all of the net earnings of the hotel not paid to the Trustee as additional rent must be applied to the retirement of outstanding interests. Such application would improve substantially the intrinsic worth of the interests not retired, and at the same time would undoubtedly sustain the market price of those interests, both of which results are of great value to the certificate holders. It seems clear enough, therefore, that whether the lease provided for in the Cleveland Hotel Plan is compared with the existing lease or is considered abstractly on its own merits, it is a very favorable lease for the Trustee and the certificate holders, and a lease much more favorable to them than they could reasonably expect to negotiate with a stranger to the reorganization.

Moreover, there is very little doubt that before one-half of the presently outstanding interests are retired, and the lessee under the proposed lease can commence to take down anything out of the operations of the Cleveland Hotel, the Trustee and the certificate holders will have received cash benefits out of the net earnings of the hotel in an amount in excess of the Trustee's claim for back rent. On the average, about three-fifths of the amount devoted out of the net earnings of the Cleveland Hotel to the retirement of interests will be devoted to additional rent.<sup>7</sup> It is, of course, impossible to predict just how much the purchase price of one-half of the presently outstanding interests will be. However, the record indicates (R. 688) that the market price of interests in March, 1944, was 89 (\$445.00 per interest) and all counsel will probably concede

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<sup>7</sup> At the beginning, before the retirement of any interests, the net earnings are divided equally between additional rent and the retirement of interests, or in the ratio of one to one. As the retirement of interests approaches one-half of the interests presently outstanding, the division of the net earnings between additional rent and the retirement of interests will approach the ratio of one to three. The mean ratio is, therefore, three to five.

that the present price is above 100 (\$500.00 per interest). It is further probable that the price will be maintained as interests are retired. Assuming, therefore, for illustration, that one-half of the presently outstanding interests are purchased at 100 (\$500.00 per interest) in the one case, and at 90 (\$450.00 per interest) in the other case, the result would be as follows:

	<i>At 100</i>	<i>At 90</i>
Cost of 3500 interests	\$1,750,000	\$1,575,000
Concurrent additional rent paid to Trustee	1,050,000	945,000
Total	\$2,800,000	\$2,520,000

Thus it will be seen that even if one-half of the presently outstanding interests are purchased at 90, the Trustee and the certificate holders, before the lessee can take down anything out of the operations of the Cleveland Hotel, will receive as additional rent an amount approaching the Trustee's back rent claim, and in addition thereto \$1,575,000.00 will have been expended in retiring interests, thereby correspondingly increasing the intrinsic worth of the interests not retired. In other words, directly and indirectly, the certificate holders will have benefited to the extent of \$2,520,000.00 before the lessee can get anything. As the purchase price of the interests rises, the result will be even more favorable to the certificate holders, as shown in the foregoing table in the "At 100" column.

Under the Cleveland Hotel Plan none of the Trustee's security is passed either to the Building Company or its unsecured creditors. All of that security (and more) is pledged to the Trustee against the new Cleveland Hotel lease. Under the new lease, neither the lessee thereunder nor its stockholder, the Building Company, can realize one dollar of profit out of the hotel or its operations until the certificate holders have benefited, directly or indirectly, over and above the fixed rent, to an extent largely in excess

of the present value of the Trustee's back rent claim. As demonstrated above, the new lease is a very favorable one to the Trustee, and there is put back of the new lease property of a value in excess of \$125,000.00, in or against which the Trustee has no right or claim. For whatever concession in its strict legal rights the Trustee makes in the Cleveland Hotel Plan, it is abundantly clear that the Trustee and the certificate holders receive, through the new lease, a fair *quid pro quo*. These facts are the quick answer to all of the petitioners' objections, including those which charge that the Plan recognizes an equity of the Building Company which does not exist, and gives to the Building Company an inequitable amount of stock in the new hotel company which will become the lessee of the hotel under the new lease. The Trustee did not develop the Cleveland Hotel Plan on any theory that the Building Company had any equity in the existing lease. The Plan gives recognition to the lessee in the proposed new lease only for long, successful operation of the Cleveland Hotel in the future, *and postpones that recognition until the lessee has earned it by performance resulting in very substantial benefits to the certificate holders.* If the lessee does not earn recognition by such performance, the hotel and the security for the new lease will come back to the certificate holders, and, in the meantime, they will have had the benefit, directly or indirectly, of the entire net earnings, of the hotel.

As the Circuit Court of Appeals said in its opinion (R. 836; 839) :

"In our judgment, the approved plan of reorganization in the instant case conforms to the standard established in *Group of Investors, supra*, [the Milwaukee case], and does not conflict with the holding in the *Los Angeles Lumber Co.* case, or the principles therein declared."

\* \* \* \* \*

"As has been indicated, it is our judgment that, for concession of its strict legal rights, the trustee under

the plan of reorganization of the lessee-debtor receives a fair and equitable consideration for execution of the new lease for the benefit of the beneficiaries of the trust."

#### The Denial of General Intervention to Petitioners.

The allowance of a general intervention to the petitioners was a matter in the District Court's discretion, and the denial by the District Court of a general intervention to the petitioners is not reviewable here. Moreover, the petitioners have not been prejudiced by the action of the District Court in denying them a general intervention.

It is conceded (Petitioners' Petition, page 8) that the allowance of a general intervention to the petitioners was a matter in the discretion of the District Court. Under Section 207 of the Bankruptcy Act, the District Court might have permitted the petitioners to intervene generally, but it was not required to do so, and it exercised its discretion against allowing to the petitioners a general intervention. That exercise of discretion is not reviewable here. The petitioners' counsel were permitted by the District Court (R. 81), and by the Circuit Court of Appeals, both on brief and by oral argument, to present fully their views on the issues here involved. They were granted as full an opportunity to be heard as if they had been allowed a general intervention. The petitioners, therefore, have not been prejudiced in any way by their failure to obtain a general intervention.

#### IN CONCLUSION.

It is submitted, therefore, that the petition for writ of certiorari should be denied..

JOHN T. SCOTT,  
BROOKS W. MACCRACKEN,

*Attorneys for Respondent,  
The National City Bank of Cleveland,  
Successor Trustee.*

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In the Supreme Court of the United States

OCTOBER TERM, 1946.

No. 448.

IN THE MATTER OF  
VAN SWERINGEN CORPORATION,

*Debtor,*

and

THE CLEVELAND TERMINALS BUILDING COMPANY,  
*Subsidiary Debtor.*

THE CLEVELAND HOTEL PROTECTIVE COMMITTEE,  
J. C. LINCOLN, GORDON MACKLIN, ROBERT H. JAMISON,  
MELVIN B. HOTT AND ROY BRENHOLTS,  
Individually and as Members of said Committee,

and

THE HENRY GEORGE SCHOOL OF SOCIAL SCIENCE,  
Intervening Petitioners,  
*Petitioners,*

vs.

THE NATIONAL CITY BANK OF CLEVELAND,  
Successor Trustee,  
and

THE CLEVELAND TERMINALS BUILDING COMPANY,  
*Respondents.*

IN PROCEEDINGS FOR THE REORGANIZATION  
OF A CORPORATION.

ON PETITION FOR WRIT OF CERTIORARI,  
TO THE UNITED STATES CIRCUIT COURT OF APPEALS,  
FOR THE SIXTH CIRCUIT.

REJOINDER BRIEF FOR RESPONDENT,  
THE NATIONAL CITY BANK OF CLEVELAND,  
SUCCESSOR TRUSTEE,  
OPPOSING PETITION FOR WRIT OF CERTIORARI.

**INTRODUCTION.**

Counsel in the Reply Brief of Petitioners continue to persist in ignoring a number of undisputed facts; at the same time, they take unjustified liberties in paraphrasing the arguments of this respondent. In this situation, a short rejoinder to the Petitioners' Reply Brief seems in order.

As in the brief heretofore filed for it, the respondent, The National City Bank of Cleveland, Successor Trustee, will hereinafter be referred to as the "Trustee," and the respondent, the subsidiary debtor, The Cleveland Terminals Building Company, will hereinafter be referred to as the "Building Company."

**THE FACTS.**

Among the undisputed facts, most of which are ignored in the Petitioners' Reply Brief, are the following:

1. The Trustee, as Successor Trustee under the Declaration of Trust, dated April 1, 1927, owns a title to the Cleveland Hotel property. Under said Declaration of Trust there have been issued so-called fee ownership certificates evidencing seven thousand equal interests. Irrespective of how those interests may be characterized, they are subject to the provisions of the Declaration of Trust, which provides, *inter alia*, in Article V (R. 116) as follows:

"In the event that the Lessee shall make default in any of the provisions of the Lease \* \* \* then the Trustee shall have full authority to terminate the Lease \* \* \*, and in such case *or in any other contingency* to take such other action with respect to the Lease or Trust Estate as it shall deem advisable, without reference to the Beneficiaries and as if it were the sole legal and equitable owner thereof \* \* \*." (Italics ours.)

and in Article XIV (R. 122) as follows:

"This Declaration may be amended by written instrument executed and acknowledged by the Trustee and consented to in writing by three-fourths in interest of the Beneficiaries [the certificate holders]."

2. The Building Company holds a lease from the Trustee on the Cleveland Hotel property. In the estate of the Building Company under this lease the certificate holders have no interest of any kind or character.

3. There is owing to the Trustee from the Building Company certain back rent under the lease to the Building Company. The certificate holders are not creditors of the Building Company in respect of this back rent. The creditor of the Building Company in respect of this back rent is the Trustee (R. 100-101).

4. The Trustee is the sole creditor of the Building Company in respect of the back rent under the lease to the Building Company, and is the only creditor in its class. There was involved here, therefore, no question of the acceptance of the Cleveland Hotel Plan by creditors holding two-thirds in amount of the claims in the Trustee's class.

5. The Trustee, as the only creditor in its class, accepted the Cleveland Hotel Plan. The Plan was so accepted by the Trustee, however, only after it had received, in accordance with the provisions of Article XIV of the Declaration of Trust quoted above, written consents to and approvals of the Plan of three-fourths in interest of the certificate holders.

#### **THE PETITIONERS' ARGUMENTS.**

Counsel argue (Petitioners' Reply Brief, pages 2-3) that this respondent claims that the Cleveland Hotel Plan need not be fair and equitable. That is not this respondent's claim; its claim is rather that the Plan meets that test. The Cleveland Hotel Plan gives to the Trustee the alternative of taking a rejection of its existing lease with all the consequences incident to such rejection, or of accepting a modified lease on the terms proposed in the Plan. Since under the Cleveland Hotel Plan the Trustee could have its strict legal rights as upon rejection if it wanted them, the Plan is fair and equitable. It was so

held in the *Milwaukee* case, 318 U. S. 523; 532-534, 546-547, and in the *New Haven* case, 147 F. (2d) 40 (certiorari denied, 325 U. S. 884; rehearing denied, 325 U. S. [No. 2] xviii). Obviously, any plan which gives to a creditor the option to have its strict legal rights if it wants them must be fair and equitable, for the strict legal rights of a creditor are the maximum to which it is entitled in any event.

Counsel also claim (Petitioners' Reply Brief, pages 4-5) that the Cleveland Hotel Plan treats the Cleveland Hotel property as if it were an asset of the Building Company, and the certificate holders as if they were creditors of the Building Company; and counsel argue that the Cleveland Hotel Plan is, therefore, distinguishable from the plan in respect of the Terre Haute lines involved in the *Milwaukee* case. The factual hypothesis upon which counsel base this conclusion is absolutely untrue. The Cleveland Hotel Plan does not treat the certificate holders as creditors of the Building Company; it treats the Trustee as the creditor of the Building Company in accordance with the record (R. 100-101). Nor does the Cleveland Hotel Plan treat the Cleveland Hotel property as if it were an asset of the Building Company. The Cleveland Hotel Plan does not deal with the title of the Trustee in respect of the Cleveland Hotel property, or with the interest of the certificate holders therein. The Cleveland Hotel Plan deals, so far as relevant here, only with the estate of the Building Company under its lease, and with the claim of the Trustee against the Building Company for back rent and the security therefor. In the respects herein referred to, there is no difference between the Cleveland Hotel Plan and the plan as to the Terre Haute lines involved in the *Milwaukee* case and the plan involved in the *New Haven* case.

The argument of counsel (Petitioners' Reply Brief, pages 9-18) that the Cleveland Hotel Plan is not fair and equitable runs as follows: The lessee under the new lease proposed in the Cleveland Hotel Plan will be a new cor-

poration; of the assets of the new corporation, the Building Company will contribute 22% (being assets in or against which the Trustee now has no right or claim); of the assets of the new corporation, the Trustee will contribute 78% (being assets upon which the Trustee now has a lien for back rent); and counsel then argue that, in this situation, the stock of the new corporation should be distributed between the Building Company and the Trustee in the percentages aforesaid, and that it is not fair and equitable to distribute all of the stock of the new corporation to the Building Company. Here again counsel ignore undisputed facts. Their argument disregards, for the most part, the provisions of the Cleveland Hotel Plan with respect to the new lease which the Trustee will receive under the Plan. This new lease is a very valuable one to the Trustee and the certificate holders. (See discussion\* Trustee's Brief, pages 14-23.) To secure the new lease the Cleveland Hotel

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\* One comment of counsel in Petitioners' Reply Brief in respect of the new lease provided for in the Cleveland Hotel Plan should perhaps be noticed, inasmuch as no such comment appears in the previous brief for the petitioners. They claim (Petitioners' Reply Brief, page 14) that as interests are purchased out of net earnings (as provided for in the Cleveland Hotel Plan) the aggregate dollar amount of rent to be paid by the lessee to the Trustee (for the payment of fixed rent and on account of earnings) will be reduced. They fail to point out, however, as in all fairness they should, that as interests are purchased, the amount to be received by the individual certificate holders whose interests are not purchased will be increased. For example, if we assume in a given year hotel earnings, before fixed rent, in the amount of \$210,000.00, then

- (1) When there are 7,000 publicly held interests the amount of rent to be received by each for that year would be
  - (a) \$25 as fixed rent;
  - (b) \$2.50 on account of earnings, computed as follows:  
\$35,000.00 (\$210,000.00—\$175,000.00 fixed rent)  $\times \frac{1}{2} \times \frac{1}{7000}$ .

- (2) When there are 5000 publicly held interests the amount of rent to be received by each for that year would be

*(Continued on following page)*

Plan provides that there shall be pledged all of the assets of the new corporation, including the assets contributed to the new corporation by the Building Company. Through this new lease the Trustee receives a fair and equitable consideration for waiving its security for part of its back rent claim, and permitting the disposition of that security and the disposition of the stock of the new corporation as provided for in the Cleveland Hotel Plan. No amount of argument can alter the plain facts that the new lease is a very favorable one to the Trustee; that there is put back of the new lease by the Building Company property of a value of about \$138,000.00, in or against which the Trustee now has no right or claim; and that under the new lease neither the lessee thereunder nor its stockholder, the Building Company, can realize one dollar of profit out of the hotel or its operations until the certificate holders have benefited, directly or indirectly, over and above the fixed rent, to an extent largely in excess of the present value of the Trustee's back rent claim. We quite fail to see how anyone can reasonably claim that the Building Company should put about \$138,000.00 into the new corporation and get only 22% of its stock, when under the terms of the Cleveland Hotel Plan that investment will be frozen without the possibility of return upon it to the Building Com-

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*(Continued from preceding page)*

- (a) \$25 as fixed rent;
- (b) \$6.07 on account of earnings, computed as follows:  
\$85,000.00 (\$210,000.00—\$125,000.00 fixed rent)  $\times \frac{1}{2} \times \frac{1}{700}$ .

In short, the reduction of the number of publicly held interests works to the advantage of the holders of interests not purchased by increasing their security and their assurance that the fixed rent will be paid and by enlarging their share of the hotel earnings. Provisions for the purchase of interests of the character provided in the Cleveland Hotel Plan are usual in land trust certificate issues and are customarily found in many other types of securities. They are generally recognized as advantageous to the security holders because they reduce the amount of the securities as the property ages.

pany until the Trustee, and through it the certificate holders, have benefited, directly or indirectly, to the extent of probably something like \$2,500,000.00.\* For whatever concession in its strict legal rights the Trustee makes in the Cleveland Hotel Plan, it is abundantly clear that the Trustee and the certificate holders receive through the new lease a fair *quid pro quo*. The Trustee was so convinced as a matter of business judgment; and the courts below so held. As the Circuit Court of Appeals said in its opinion (R. 836) :

“\* \* \* In all the circumstances, the plan which the district court confirmed seems fair and equitable to the beneficiaries of the lessor-trustee; and it appears that the trustee exercised good business judgment in advocating acceptance of the plan of reorganization of the lessee-debtor.”

and (R. 839) :

“As has been indicated, it is our judgment that, for concession of its strict legal rights, the trustee under the plan of reorganization of the lessee-debtor receives a fair and equitable consideration for execution of the new lease for the benefit of the beneficiaries of the trust.”

#### IN CONCLUSION.

It is submitted, therefore, that the petition for writ of certiorari should be denied.

JOHN T. SCOTT,

BROOKS W. MACCRACKEN,

*Attorneys for Respondent,*

*The National City Bank of Cleveland,  
Successor Trustee.*

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\* See discussion Trustee's Brief, pages 20-21.

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REJOINDER BRIEF OF THE CLEVELAND  
TERMINALS BUILDING COMPANY, RESPONDENT.

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(Names of Counsel on inside of Cover.)

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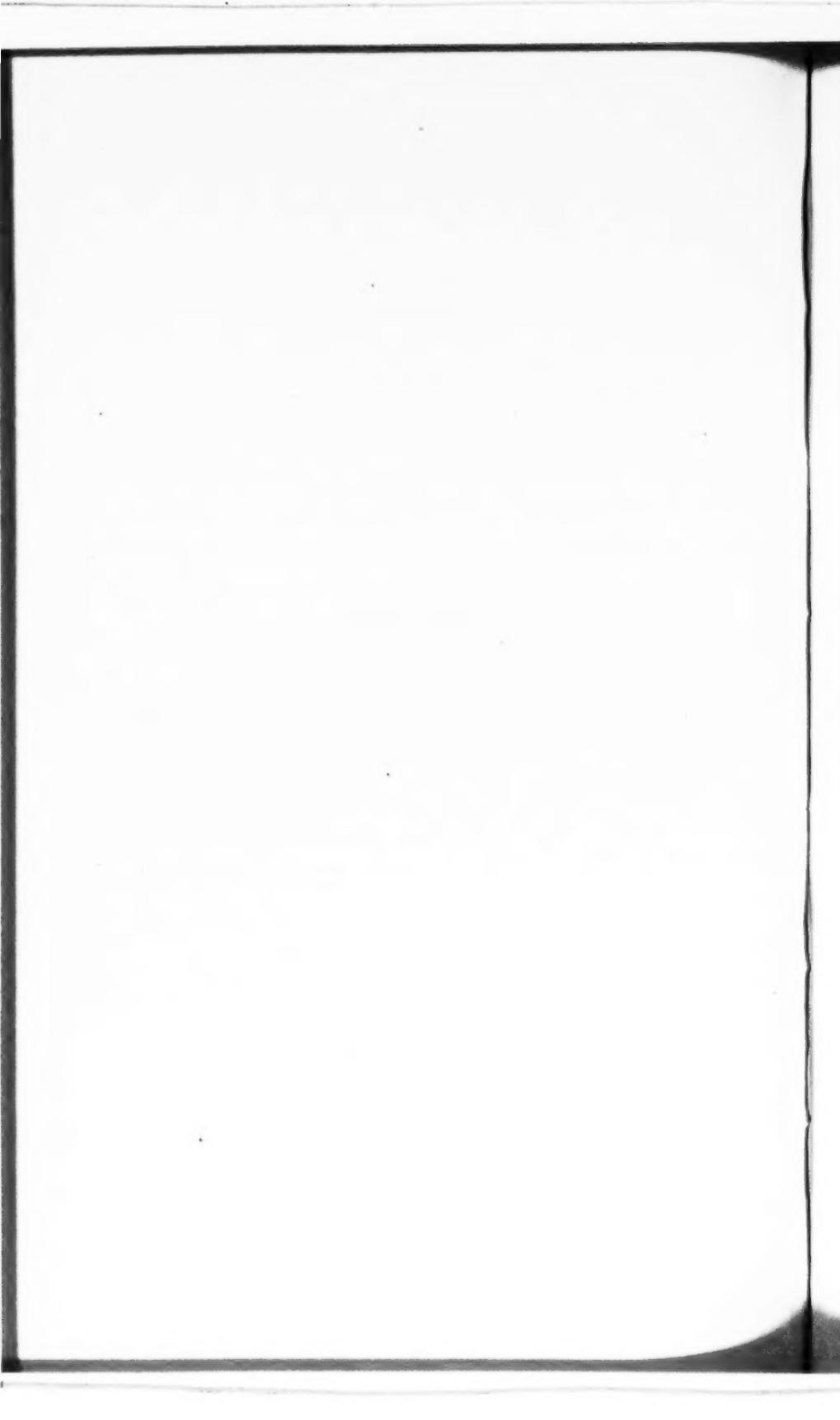
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TERMINALS BUILDING COMPANY, RESPONDENT.

## **INTRODUCTION.**

The reply brief filed by petitioners is in reality a second main brief—not a rebuttal. This makes it permissible and appropriate to file a short rejoinder thereto.

### I.

#### **FAIRNESS AND EQUITY.**

Petitioners question why Subsidiary Debtor should have 100% of the stock of the proposed new lessee corporation, when (as petitioners say) it contributes only 22% of the capital. The answer is short and simple.

The factor which makes the Plan fair and equitable in spite of that allocation of stock is the manifest advantage and desirability of the lease, in its modified form, from the landlord's point of view. That an advantageous lease can be an asset to a landlord is elementary. That it may in a particular case be advantageous enough to justify a landlord's paying something to get it (by contribution to the lessee or otherwise) should occasion no surprise.

The details of the advantages to the landlord in the revised Cleveland Hotel lease are set forth in our main brief at pages 17 to 23—the opportunity for increased rent, the ready market for those who wish to sell their land trust certificates immediately, the assurance of eventual recovery of all of the original investment for those who await the call of their certificates, the improved chattel mortgage, the hypothecation of the stock of the proposed new lessee corporation, and the lessee's foregoing all compensation until the landlord's security is made absolutely sound by the purchase of at least one-half of the outstanding interests.

These advantages are a fair and equitable compensation in money's worth for the surrender of the security on

the back rent claim and the acceptance for that claim of stock of the Subsidiary Debtor, and a small cash payment. The Trustee thought so, three-fourths in interest of the certificate holders thought so, the Special Master thought so, the District Judge thought so, and the three Judges of the Circuit Court of Appeals thought so. Moreover, this conclusion has been made a specific part of the finding and judgment of the Court. See the Order of Confirmation of the Hotel Plan, wherein the Trial Court specifically found

"(n) that the Cleveland Hotel Plan is fair and equitable" (R. 89).

## II.

### **THE LANDLORD'S OPTION.**

Under the heading of "Failure to Accept," the Plan provides:

"In case the holder or holders of any such secured claim shall also sustain the relation of landlord to The Cleveland Terminals Building Company, then The Cleveland Terminals Building Company may, under appropriate orders of the Court, reject the lease involved in such relation \* \* \*"<sup>1</sup>

Thus the landlord here had an option: Either it could accept the Plan proposed to it, or in the alternative it might expect to have its strict legal rights upon rejection. It could either

- (a) Accept the Plan, or
- (b) Take over the Hotel Building, with its furniture, fixtures, and equipment, and proceed to deal with them as best it could.

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<sup>1</sup> See Article VIII, Section VIII, subsection 5, page 46 of the General Plan of Reorganization of The Cleveland Terminals Building Company (an unnumbered physical Exhibit).

Thus the Plan constituted an offer which the landlord was free to accept or reject, as it saw fit.

This is exactly the alternative which faced the Terre Haute interests in the *Milwaukee* case,<sup>2</sup> and the Boston Terminal interests in the *New Haven* case.<sup>3</sup> In the former case the Court said at page 546:

“The Terre Haute bondholders were in effect given the option to take the Terre Haute lines back or agree to a reduced rental.”

In the latter case the Court said at page 52:

“The provisions were \* \* \* an offer of a revised arrangement which the Terminal Company is free to accept or reject \* \* \*.”

In each case the acceptance of the Plan was sustained. The situation in the instant case is the same. The Trustee was in effect given the option to take the hotel back or to agree to a modification of the lease and a waiver of its strict legal rights with reference to the property covered by the chattel mortgage.

In practical effect, the Trustee is in the same position as though it had

- (a) declared a forfeiture of the lease and a forfeiture of the chattel mortgage;
- (b) taken possession of the hotel building, and the furniture, fixtures, and equipment;
- (c) set out, thus entrenched, to find a new lessee;
- (d) found a prospective tenant with satisfactory managerial ability which would take a percentage

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<sup>2</sup> *Group of Institutional Investors, et al. vs. Chicago, Milwaukee, St. Paul and Pacific Railroad Company* (1943), 318 U. S. 523.

<sup>3</sup> *New York, New Haven & Hartford Railroad Co., In re*, (C. C. A. Conn. 1945), 147 F. (2d) 40 (Certiorari denied in 325 U. S. 884; rehearing denied, 325 U. S. [No. 2] XVIII).

lease upon rental terms which the Trustee regarded as highly desirable, but would take it only upon condition that the Trustee contribute the furniture, fixtures, and equipment to the lessee and accept a new chattel mortgage thereon; and

- (e) decided to accept said condition for the sake of obtaining a lease it regarded as more desirable than any lease which did not involve such a contribution on the landlord's part.

Thus the Trustee has had the equivalent of a recapture of all of the property and the making of the most advantageous lease possible thereon. As in the case of the Terre Haute bondholders, the landlord had in effect the option to take all the property back or to agree to modifications. Under the authority of the *Milwaukee* case the acceptance of the modifications which the Plan provided for, and which the District Court approved, is therefore valid.

### III.

#### THE DELEGATION OF CONTROL.

Under the terms of what might be called their charter papers, the certificate holders delegated to the Trustee the absolute control<sup>4</sup> of the lease, and reserved to themselves the power to amend the Declaration of Trust by a vote of

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<sup>4</sup> Article IX of the Declaration of Trust provides that:

"The Trustee may advise with legal counsel, and any action under this Trust Agreement taken or suffered in good faith by the Trustee in accordance with the opinion of such counsel shall be *conclusive on the Beneficiaries*, and the Trustee shall be fully protected in respect thereof. \* \* \*

"The Trustee shall have the *exclusive right to control* the Trust Estate as it may deem for the best interests of the Beneficiaries, *free from all control by the Beneficiaries, as fully and to the same extent as though the Trustee were the sole legal and equitable owner thereof*, and shall not be subject to any

*(Continued on following page)*

three-fourths in interest.<sup>5</sup> In the absence of fraud, which has been specifically negated by the order and judgment of the Court in this case (R. 87), these provisions are absolutely binding on the petitioners and every other certificate holder. No reason to the contrary has been shown, or even attempted to be shown. The certificate holders are in the same position as stockholders of a corporate creditor in a reorganization proceeding of its debtor—their duly constituted representative speaks for them, and they have no right to intervene, to be heard, or to appeal.

Their duly constituted representative, in the honest exercise of the discretion conferred upon it, and after advising with legal counsel, has taken action in good faith in accordance with the opinion of such counsel (See Article

*(Continued from preceding page)*

obligations to the Beneficiaries other than such as are expressly assumed hereunder.” (Emphasis ours.)

Article V provides that:

“\* \* \* the Trustee shall have full authority \* \* \* in such case (termination of lease) or in any other contingency to take such other action with respect to the Lease or Trust Estate as it shall deem advisable, without reference to the Beneficiaries and as if it were the sole legal and equitable owner thereof, and no person dealing with the Trustee shall be bound to inquire concerning the authority of the Trustee so to act.” (Emphasis ours.)

Finally, there is a provision which is no doubt expressive of the rule which would prevail anyhow, to-wit (Article XIII) that:

“By the acceptance of any Certificate issued hereunder, the original or any successive holder shall be deemed to assent to all of the provisions contained in this Trust Agreement.”

<sup>5</sup> Article XIV of the Declaration of Trust provides that:

“This Declaration may be amended by written instrument executed and acknowledged by the Trustee and consented to in writing by three-fourths in interest of the Beneficiaries.” R. 122, 639.)

IX, page 5, *supra*) ; and such action is therefore, "conclusive on the Beneficiaries," as Article IX has it.

The Trustee and more than three-fourths in interest of the certificate holders found that, rather than to have the lease rejected and the hotel back on the Trustee's hands, it would be better to accept the Plan, and to obtain the increased rental opportunity afforded thereby and the other advantages of the Plan, even at the expense of subsidizing the proposed new lessee by removing the back rent from the obligations secured by the chattel mortgage.

The dissenters now claim the right to substitute their judgment for that of the Trustee and three-fourths in interest of the certificate holders. This, in the established absence of fraud, derogated from their express contract, and cannot be permitted.

### **CONCLUSION.**

The Plan is fair and equitable; the judgment of the Trustee and three-fourths in interest of the certificate holders in preferring Acceptance of the Plan to rejection of the lease was justified; and the minority, having covenanted to abide by the judgment of the Trustee and three-fourths in interest of the beneficiaries, and there being no fraud involved, have no right to intervene, to be heard, or to appeal.

Respectfully submitted,

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